



FY 2005-06
APPROPRIATIONS REPORT
Part I - Governor's Recommendations

February 2005



Gary S. Olson, Director - Lansing, Michigan - (517) 373-2768 - TDD (517) 373-0543
Internet Address: <http://www.senate.michigan.gov/sfa>

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2. To provide written analyses of all Senate bills, House bills, and Administrative Rules considered by the Senate.
3. To review and evaluate proposed and existing State programs and services.
4. To provide economic and revenue analysis and forecasting.
5. To review and evaluate the impact of Federal budget decisions on the State.
6. To review and evaluate State issuance of long-term and short-term debt.
7. To review and evaluate the State's compliance with constitutional and statutory fiscal requirements.
8. To prepare special reports on fiscal issues as they arise and at the request of members of the Senate.

The Agency is located on the 8th floor of the Victor Office Center. The Agency is an equal opportunity employer.



Gary S. Olson, Director
Senate Fiscal Agency
P.O. Box 30036
Lansing, Michigan 48909-7536
Telephone (517) 373-2767
TDD (517) 373-0543
Internet Home Page <http://www.senate.michigan.gov/sfa>

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OVERVIEW

Governor Granholm on February 10, 2005, transmitted her fiscal year (FY) 2005-06 State Budget Message to the Legislature. The Governor's FY 2005-06 budget contains recommendations to provide for \$40.5 billion of Adjusted Gross appropriations. Included in this appropriation total are \$12.8 billion of Federal funds, \$18.4 billion of State Restricted funds, \$425.4 million of local and private funds, and \$8.9 billion of General Fund/General Purpose (GF/GP) appropriations. Table 1 and Figure A provide summaries of the overall makeup of the FY 2005-06 appropriations recommended by the Governor.

Tables 2-4 and Figures B-D provide department-by-department detail of the Governor's appropriation requests for FY 2005-06 compared with FY 2004-05 year-to-date appropriations. The tables and figures present appropriation data in terms of Adjusted Gross, State Spending from State Resources, and GF/GP appropriations. Adjusted Gross appropriations are defined as total appropriations for each department less funds transferred in from other State departments. State Spending from State Resources appropriations are defined as Adjusted Gross appropriations less Federal and local and private funds. General Fund/General Purpose appropriations are the residual unrestricted portion of the budget over which the Governor and the Legislature have the most flexibility in establishing appropriation policy. The Governor's budget proposes a 3.2% increase in Adjusted Gross appropriations, a 4.2% increase in State Spending from State Resources appropriations, and a 0.3% increase in GF/GP appropriations.

The Governor's Budget Message is developed based on the consensus revenue estimates agreed to on January 13, 2005. These consensus revenue estimates are the basis for the appropriation and tax policy changes contained in the Governor's budget recommendations. The FY 2005-06 GF/GP consensus revenue estimate represents a 3.6% increase from the FY 2004-05 consensus revenue estimate. The FY 2005-06 School Aid Fund consensus revenue estimate represents a 3.9% increase from the FY 2004-05 consensus revenue estimate. The Governor's budget also contains several recommended tax policy changes that will have an impact on the level of revenue available to support appropriations. These revenue adjustments include changes in the oil and gas severance tax, the sales and use tax, the income tax, and the property tax. The consensus revenue estimate and the proposed tax policy changes will be discussed in more detail in the **Economic and Revenue Forecast** section of this report.

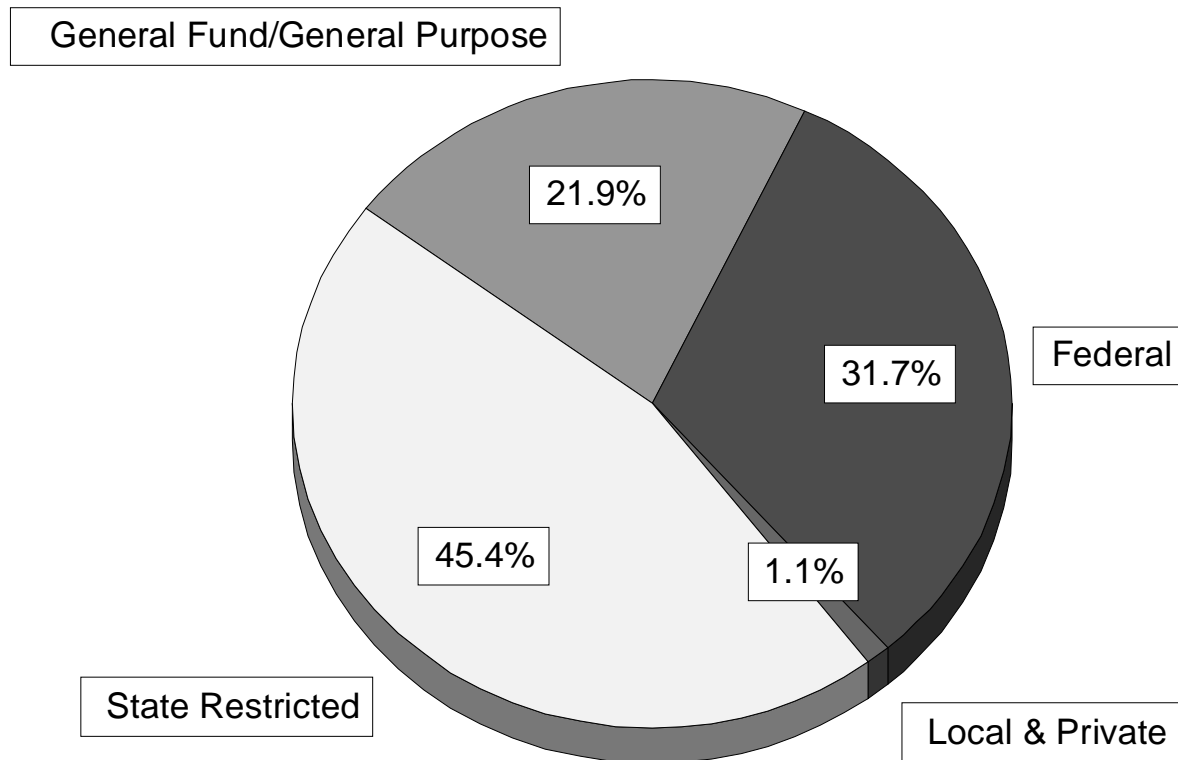
In addition to the detailed revenue and appropriation recommendations for FY 2005-06, the Governor's State Budget Message also includes adjustments to enacted FY 2004-05 appropriations to eliminate a projected deficit in the FY 2004-05 GF/GP budget. These proposals to balance the FY 2004-05 GF/GP budget will be discussed in more detail in another part of this budget overview.

Table 1

FY 2005-06 Governor's Recommendation By Source of Funds (Actual Dollars)					
Department/Budget Area	Adjusted Gross	Federal Funds	Local & Private Funds	Other State Restricted	General Funds
Agriculture	\$102,735,700	\$32,581,700	\$138,700	\$41,442,700	\$28,572,600
Attorney General	52,521,000	8,799,400	0	11,011,400	32,710,200
Capital Outlay	510,159,500	155,075,000	20,000,000	59,082,300	276,002,200
Civil Rights.....	13,335,100	1,049,800	0	0	12,285,300
Civil Service	30,617,600	4,779,100	1,850,000	16,539,200	7,449,300
Community Colleges	281,327,400	0	0	0	281,327,400
Community Health	10,206,397,800	5,467,496,800	294,900,900	1,523,360,600	2,920,639,500
Corrections	1,882,598,800	10,316,800	411,700	66,590,000	1,805,280,300
Education.....	125,141,800	67,519,400	6,342,600	23,188,200	28,091,600
Environmental Quality	356,209,100	142,995,700	450,000	182,253,100	30,510,300
Executive	5,205,500	0	0	0	5,205,500
Family Independence Agency	4,427,574,300	3,190,468,600	60,128,200	70,373,900	1,106,603,600
Higher Education	1,642,834,100	3,500,000	0	146,500,000	1,492,834,100
History, Arts, and Libraries	56,029,200	8,218,300	577,400	4,082,700	43,150,800
Information Technology.....	0	0	0	0	0
Judiciary	255,165,300	3,933,900	4,308,500	86,935,000	159,987,900
Labor and Economic Growth.....	1,475,648,700	842,527,600	19,728,800	539,543,800	73,848,500
Legislature	124,930,400	0	400,000	2,356,500	122,173,900
Management and Budget (Operations)	79,360,000	0	0	42,909,400	36,450,600
Military Affairs	115,851,700	49,537,200	1,355,800	26,610,500	38,348,200
Natural Resources.....	267,477,900	38,790,200	2,090,100	200,064,300	26,533,300
School Aid	12,809,269,100	1,374,074,500	0	11,414,994,600	20,200,000
State	176,885,700	2,333,300	100	160,287,200	14,265,100
State Police	523,345,200	170,821,000	5,609,100	107,946,900	238,968,200
Transportation	3,417,708,500	1,207,642,100	6,100,000	2,203,966,400	0
Treasury (Debt Service)	89,001,400	0	0	36,114,500	52,886,900
Treasury (Operations)	373,427,100	35,405,400	1,025,400	284,369,500	52,626,800
Treasury (Revenue Sharing)	1,121,312,000	0	0	1,121,100,000	212,000
Contract and IT Purchase Reductions	(32,100,000)	0	0	0	(32,100,000)
Total Appropriations	\$40,489,969,900	\$12,817,865,800	\$425,417,300	\$18,371,622,700	\$8,875,064,100

Figure A

Appropriations by Source of Funds FY 2005-06 Governor's Recommendation



Total = \$ 40,489,969,900

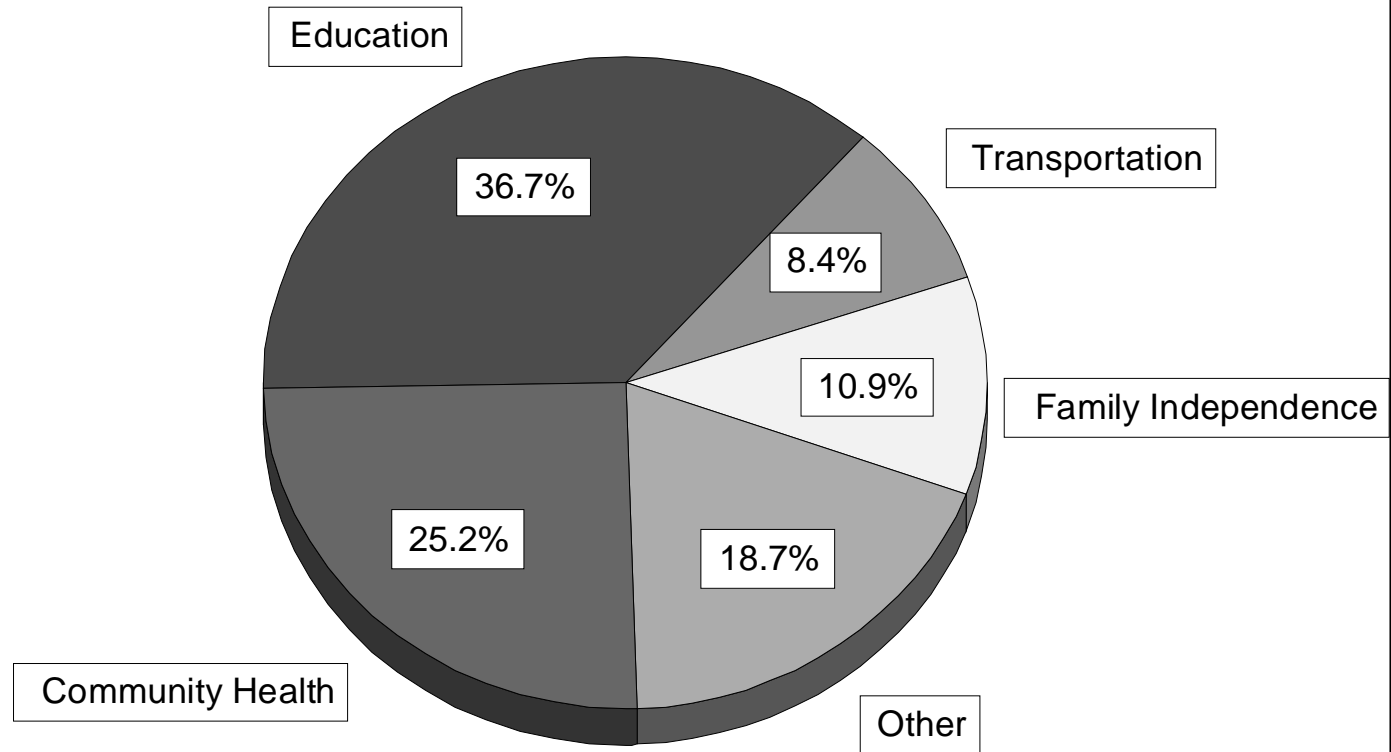
Table 2

**Adjusted Gross Appropriations
FY 2004-05 Versus Governor's Recommendation
(Actual Dollars)**

Department/Budget Area	FY 2004-05 Year-to-Date Appropriations	FY 2005-06 Governor's Recommendation	Dollar Difference	Percent Change
Agriculture	\$115,299,600	\$102,735,700	(\$12,563,900)	(10.9)%
Attorney General	50,290,200	52,521,000	2,230,800	4.4
Capital Outlay	250,989,800	510,159,500	259,169,700	103.3
Civil Rights.....	12,693,000	13,335,100	642,100	5.1
Civil Service	29,775,800	30,617,600	841,800	2.8
Community Colleges	294,268,200	281,327,400	(12,940,800)	(4.4)
Community Health	10,103,162,800	10,206,397,800	103,235,000	1.0
Corrections	1,782,818,400	1,882,598,800	99,780,400	5.6
Education.....	112,476,900	125,141,800	12,664,900	11.3
Environmental Quality	326,306,300	356,209,100	29,902,800	9.2
Executive	5,205,500	5,205,500	0	0.0
Family Independence Agency	4,297,056,900	4,427,574,300	130,517,400	3.0
Higher Education	1,733,158,700	1,642,834,100	(90,324,600)	(5.2)
History, Arts, and Libraries	56,944,600	56,029,200	(915,400)	(1.6)
Information Technology.....	0	0	0	0.0
Judiciary	248,583,200	255,165,300	6,582,100	2.6
Labor and Economic Growth	1,241,350,400	1,475,648,700	234,298,300	18.9
Legislature	124,930,400	124,930,400	0	0.0
Management and Budget (Operations)	70,334,900	79,360,000	9,025,100	12.8
Military Affairs	109,670,900	115,851,700	6,180,800	5.6
Natural Resources	260,806,700	267,477,900	6,671,200	2.6
School Aid	12,527,440,100	12,809,269,100	281,829,000	2.2
State	167,179,500	176,885,700	9,706,200	5.8
State Police	455,929,100	523,345,200	67,416,100	14.8
Transportation	3,279,058,100	3,417,708,500	138,650,400	4.2
Treasury (Debt Service)	81,450,400	89,001,400	7,551,000	9.3
Treasury (Operations)	354,902,400	373,427,100	18,524,700	5.2
Treasury (Revenue Sharing)	1,144,610,800	1,121,312,000	(23,298,800)	(2.0)
Contract and IT Purchase Reductions	0	(32,100,000)	(32,100,000)	0.0
Total Appropriations	\$39,236,693,600	\$40,489,969,900	\$1,253,276,300	3.2%

Figure B

Adjusted Gross FY 2005-06 Governor's Recommendation



Total = \$ 40,489,969,900

Table 3
State Spending from State Resources
FY 2004-05 Versus Governor's Recommendation
(Actual Dollars)

Department/Budget Area	FY 2004-05 Year-to-Date Appropriations	FY 2005-06 Governor's Recommendation	Dollar Difference	Percent Change
Agriculture	\$81,684,700	\$70,015,300	(\$11,669,400)	(14.3)%
Attorney General	41,988,900	43,721,600	1,732,700	4.1
Capital Outlay	250,989,800	335,084,500	84,094,700	33.5
Civil Rights.....	11,759,000	12,285,300	526,300	4.5
Civil Service	23,146,700	23,988,500	841,800	3.6
Community Colleges	294,268,200	281,327,400	(12,940,800)	(4.4)
Community Health	4,021,705,300	4,444,000,100	422,294,800	10.5
Corrections	1,774,236,700	1,871,870,300	97,633,600	5.5
Education.....	45,864,700	51,279,800	5,415,100	11.8
Environmental Quality	192,093,600	212,763,400	20,669,800	10.8
Executive	5,205,500	5,205,500	0	0.0
Family Independence Agency	1,180,004,200	1,176,977,500	(3,026,700)	(0.3)
Higher Education	1,728,658,700	1,639,334,100	(89,324,600)	(5.2)
History, Arts, and Libraries	48,215,900	47,233,500	(982,400)	(2.0)
Information Technology.....	0	0	0	0.0
Judiciary	240,427,000	246,922,900	6,495,900	2.7
Labor and Economic Growth	385,038,600	613,392,300	228,353,700	59.3
Legislature	124,530,400	124,530,400	0	0.0
Management and Budget (Operations)	69,890,300	79,360,000	9,469,700	13.5
Military Affairs	62,970,500	64,958,700	1,988,200	3.2
Natural Resources	221,587,200	226,597,600	5,010,400	2.3
School Aid	11,173,900,000	11,435,194,600	261,294,600	2.3
State	165,788,400	174,552,300	8,763,900	5.3
State Police	344,982,200	346,915,100	1,932,900	0.6
Transportation	2,140,556,900	2,203,966,400	63,409,500	3.0
Treasury (Debt Service)	81,450,400	89,001,400	7,551,000	9.3
Treasury (Operations)	319,256,300	336,996,300	17,740,000	5.6
Treasury (Revenue Sharing)	1,126,742,300	1,121,312,000	(5,430,300)	(0.5)
Contract and IT Purchase Reductions	0	(32,100,000)	(32,100,000)	0.0
Total Appropriations	\$26,156,942,400	\$27,246,686,800	\$1,089,744,400	4.2%

Figure C

State Spending from State Resources FY 2005-06 Governor's Recommendation

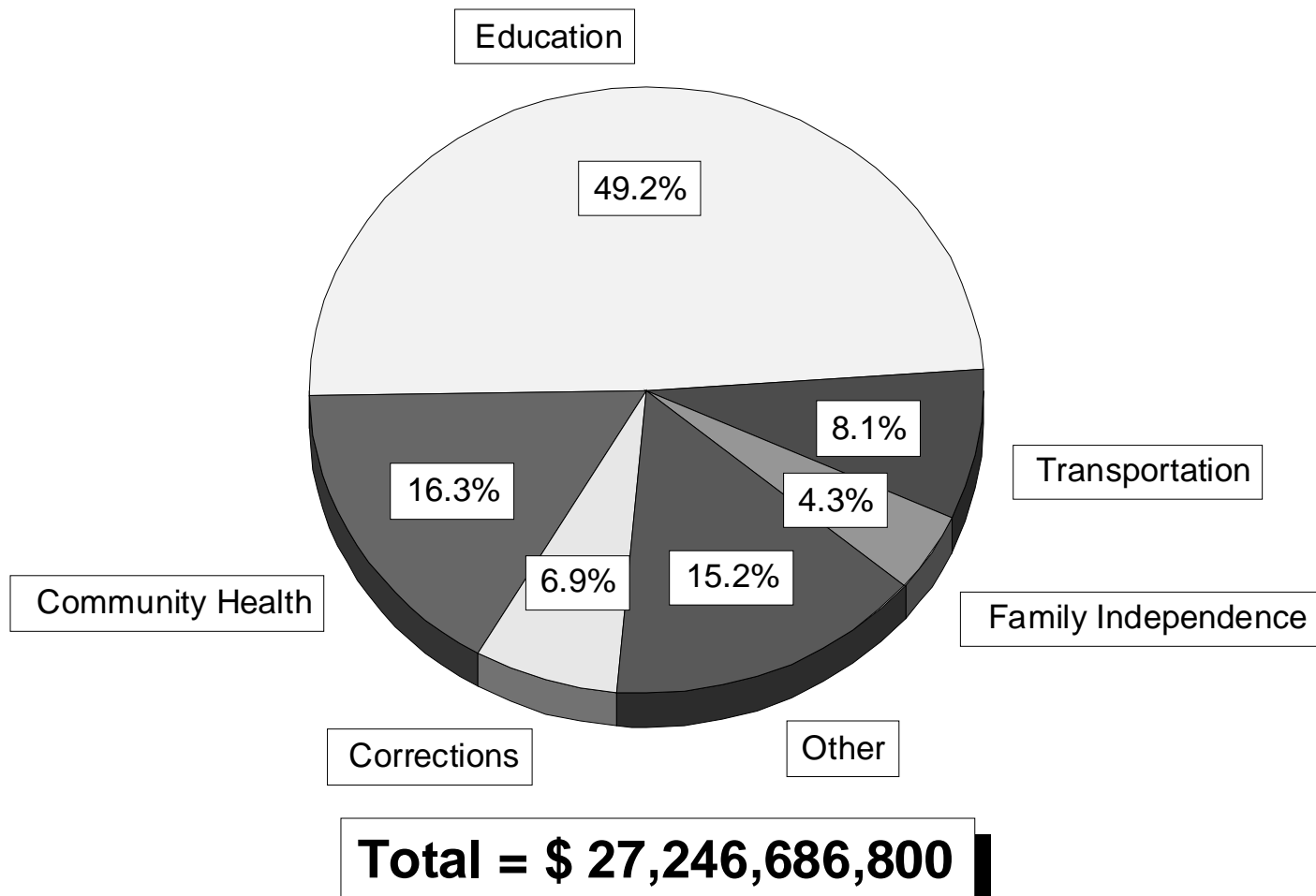


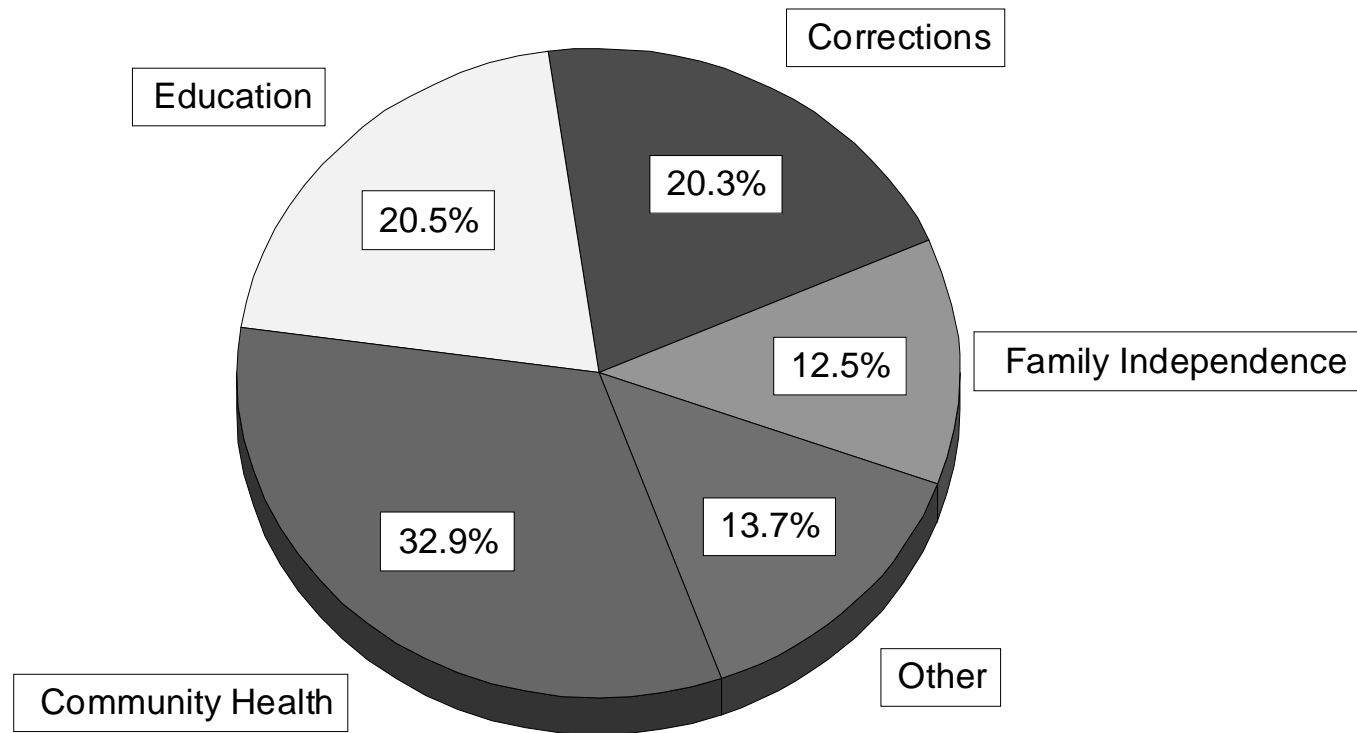
Table 4

**General Fund/General Purpose
FY 2004-05 Versus Governor's Recommendation
(Actual Dollars)**

Department/Budget Area	FY 2004-05 Year-to-Date Appropriations	FY 2005-06 Governor's Recommendation	Dollar Difference	Percent Change
Agriculture	\$30,091,400	\$28,572,600	(\$1,518,800)	(5.0)%
Attorney General	31,503,900	32,710,200	1,206,300	3.8
Capital Outlay	243,194,800	276,002,200	32,807,400	13.5
Civil Rights.....	11,759,000	12,285,300	526,300	4.5
Civil Service	7,672,100	7,449,300	(222,800)	(2.9)
Community Colleges	294,268,200	281,327,400	(12,940,800)	(4.4)
Community Health	2,557,860,600	2,920,639,500	362,778,900	14.2
Corrections	1,708,161,100	1,805,280,300	97,119,200	5.7
Education.....	26,394,700	28,091,600	1,696,900	6.4
Environmental Quality	28,671,800	30,510,300	1,838,500	6.4
Executive	5,205,500	5,205,500	0	0.0
Family Independence Agency	1,109,682,800	1,106,603,600	(3,079,200)	(0.3)
Higher Education	1,643,508,700	1,492,834,100	(150,674,600)	(9.2)
History, Arts, and Libraries	45,803,500	43,150,800	(2,652,700)	(5.8)
Information Technology.....	0	0	0	0.0
Judiciary	158,093,300	159,987,900	1,894,600	1.2
Labor and Economic Growth	94,538,000	73,848,500	(20,689,500)	(21.9)
Legislature	122,173,900	122,173,900	0	0.0
Management and Budget (Operations)	36,684,200	36,450,600	(233,600)	(0.6)
Military Affairs	37,370,700	38,348,200	977,500	2.6
Natural Resources (Operations).....	28,885,000	26,533,300	(2,351,700)	(8.1)
School Aid	264,700,000	20,200,000	(244,500,000)	(92.4)
State	23,909,900	14,265,100	(9,644,800)	(40.3)
State Police	244,380,200	238,968,200	(5,412,000)	(2.2)
Transportation	0	0	0	0.0
Treasury (Debt Service)	42,448,600	52,886,900	10,438,300	24.6
Treasury (Operations)	53,262,500	52,626,800	(635,700)	(1.2)
Treasury (Revenue Sharing)	442,300	212,000	(230,300)	(52.1)
Contract and IT Purchase Reductions	0	(32,100,000)	(32,100,000)	0.0
Total Appropriations	\$8,850,666,700	\$8,875,064,100	\$24,397,400	0.3%

Figure D

General Fund/General Purpose FY 2005-06 Governor's Recommendation



Total = \$ 8,875,064,100

Summary of Major Changes for FY 2005-06

The Governor's FY 2005-06 budget proposal marks the third State budget that Governor Granholm has transmitted to the Legislature. The Governor's budget proposal contains revenue increases from proposed tax policy changes, fee increases, appropriation increases to cover projected State expenditures, appropriation reductions for existing State programs, and assumptions concerning the level of Federal funds to be available to support appropriations in the budget.

As previously stated, the Governor's FY 2005-06 budget recommendation is built on assumptions as to the level of revenue available to support appropriations. Table 5 provides a summary of the amount of total GF/GP revenue that will be available to support FY 2005-06 GF/GP appropriations. Total FY 2005-06 GF/GP revenue assumed in the Governor's budget equals \$8.88 billion. This revenue total includes \$8.16 billion of consensus revenue and \$608.4 million of enacted revenue adjustments not included in the consensus revenue estimate. These enacted revenue adjustments include adjustments to revenue sharing payments to cities, villages, townships, and counties, caps on interfund borrowing costs, and assumptions concerning the use of a pharmaceutical tax credit. The Governor's budget also includes \$114.2 million of other proposed revenue adjustments that will have an impact on the level of GF/GP revenue. These include revenue from the sale of surplus State property, increased escheats revenue from enforcement of escheat laws, revenue from tax policy changes, fund transfers from the Agriculture Equine Industry Development Fund, fund transfers from the Comprehensive Transportation Fund, and revenue from a liquor license fee increase.

Table 6 provides a comparison of the Governor's recommended level of FY 2005-06 appropriations with the year-to-date level of FY 2004-05 GF/GP appropriations. The Governor's recommendation represents a \$24.4 million increase in GF/GP appropriations. Table 6 provides a high-level summary of the three approaches recommended by the Governor that lead to this increase in overall GF/GP appropriations. The \$24.4 million of appropriation increases consists of \$474.7 million of GF/GP appropriation increases, \$635.4 million of GF/GP appropriation reductions, and \$185.1 million of GF/GP funding increases from fund shifts that do not affect the overall level of State programs.

Table 7 provides a summary of the \$474.7 million of GF/GP appropriation increases included in the FY 2005-06 budget recommendation. These appropriation increases can be grouped into three broad categories. First are increases dealing with caseload and general cost adjustments. Included in this group are funding increases in the State Medicaid program, Corrections funding increases, and Family Independence Agency caseload adjustments. The second broad type of funding increase is debt service requirements on bonds issued by the State Building Authority and General Obligation bonds. The final category of appropriation increases involves costs associated with the funding of State employees. This includes funding for the elimination of prior employee concessions, health insurance cost increases, and pension cost increases. The Governor's budget recommendation does not include increased funding for the pay increases State classified employees will receive next year based on negotiated contracts. The State departments will absorb the cost of these salary adjustments out of existing resources.

Table 5

Governor's FY 2005-06 State Budget Proposed General Fund/General Purpose Revenue Available to Support Appropriations (Millions of Dollars)	
Revenue:	
Consensus Revenue Estimate	\$8,156.2
Enacted Revenue Adjustments:	
Revenue Sharing Freeze	396.1
County Revenue Sharing Suspension	182.3
Cap on Interfund Borrowing Rates	20.0
Nonuse of SBT Pharmaceutical Credit	10.0
Subtotal Enacted Revenue Adjustments	608.4
Subtotal Current Law Revenue	\$8,764.6
Proposed Revenue Adjustments:	
Land Sales	10.0
Enhanced Escheats Enforcement Revenue	10.0
Tax Policy Changes	64.0
Agriculture Equine Industry Development Fund Transfer	6.1
Comprehensive Transportation Fund Transfer	11.1
Liquor License Fee Increase	13.0
Subtotal Governor's Recommended Revenue Adjustments	\$114.2
Total Estimated Revenue	\$8,878.8

Table 6

Governor's FY 2005-06 Appropriation Recommendations Major Proposed Changes from FY 2004-05 Year-to-Date General Fund/General Purpose Appropriations (Millions of Dollars)	
FY 2004-05 Year-to-Date Appropriations	\$8,850.7
FY 2005-06 Governor's Appropriation Recommendations	8,875.1
Net Increase in Appropriations	\$24.4
Total Funding Increases	\$474.7
Total Funding Reductions	(635.4)
Total Fund Shifts	185.1
Total GF/GP Funding Change	\$24.4

Table 7

FY 2005-06 Governor's Recommendation GF/GP Major Funding Increases (Millions of Dollars)	
<u>Department/Program</u>	
<u>Capital Outlay</u>	
State Building Authority Debt Service Payments	\$31.0
<u>Community Health</u>	
Medicaid Caseload/Utilization/Inflation	214.3
<u>Corrections</u>	
New Beds	14.4
Prisoner Re-entry Pilot Program	5.0
Prisoner Re-entry for Mentally Ill Prisoners	3.0
Programs for Local Jails.....	4.0
Community Corrections Programs	3.0
Full-Year Costs of FY 2004-05 Prison Beds	3.9
Staff Seniority Step Increases.....	8.1
Substance Abuse Testing and Treatment.....	2.0
<u>Education</u>	
School Breakfast Program	1.6
<u>Family Independence Agency</u>	
Net Caseload Funding Increases.....	8.2
Information Technology Initiatives for Caseworkers	8.5
<u>Judiciary</u>	
Judges Salaries.....	0.4
<u>Treasury - Debt Service</u>	
General Obligation Bond Debt Service	7.6
Departmentwide Economic Issues:	
Elimination of FY 2004-05 Employee Concessions	76.3
Employee Insurance Cost Increases.....	37.5
Employee Retirement Cost Increases.....	44.3
Worker's Compensation Cost Adjustments.....	(2.5)
Building Occupancy Charges	4.1
Total Funding Increases	\$474.4

Table 8 provides a summary of the \$635.4 million of GF/GP appropriation reductions recommended in the FY 2005-06 budget. The largest appropriation reduction is a \$244.5 million reduction in the level of GF/GP appropriations transferred to the School Aid Fund. Other major appropriation reductions include the elimination of private tuition grants in the Higher Education budget, a 4.0% reduction to Medicaid providers, savings from reductions in the level of State contracts, and numerous other funding reductions.

Table 8

FY 2005-06 Governor's Recommendation GF/GP Major Funding Reductions (Millions of Dollars)	
<u>Community Colleges</u>	
Continuation of 1.76% Executive Order 2005-03 Reduction	\$(4.9)
Elimination of FY 2004-05 One-Time Funding	(8.5)
<u>Community Health</u>	
Medicaid Providers (4.0% Reduction)	(63.5)
Local Public Health Vision and Hearing Screening	(5.2)
Medicaid (Freeze Enrollment for 19- and 20-Year-Olds).....	(2.2)
Medicaid (Eliminate Retroactive Benefits).....	(12.3)
Medicaid (Reduce Benefits for 19- and 20-Year-Olds and Caretaker Relatives).....	(2.8)
Medicaid (Eliminate Chiropractic Services).....	(0.6)
Medicaid (Change Asset Requirements for Nursing Home Residents).....	(8.0)
Medicaid (Institute an Estate Recovery Program)	(4.3)
Office of Services to the Aging Program Reductions	(1.5)
<u>Corrections</u>	
Facility Closures	(25.5)
Elimination of Conditional Reintegration Program.....	(3.7)
Reduction of Community Residential Programs.....	(3.1)
Decrease in Security Levels at Five Facilities	(2.9)
Various Other Corrections Reductions	(6.0)
<u>Family Independence Agency</u>	
Indigent Burial 4% Reduction	(0.2)
Day Care 30-Day Waiting Period for New Enrollees	(10.0)
Licensing Costs	(2.0)
Juvenile Justice State Facilities Efficiencies.....	(3.8)
Foster Care Expense Efficiencies	(5.0)
<u>Higher Education</u>	
Continuation of 1.76% Executive Order 2005-03 Reduction	(27.6)
Elimination of CMU National Charter School Institute Grant.....	(0.5)

Table 8 (continued)

FY 2005-06 Governor's Recommendation GF/GP Major Funding Reductions (Millions of Dollars)	
<u>Higher Education (continued)</u>	
Elimination of Tuition Grant Program for Private Colleges	(61.8)
Reduction of MSU Agricultural Experiment Station by 10%	(3.3)
Reduction of MSU Cooperative Extension Service by 23.4%	(6.7)
Elimination of One-Time FY 2004-05 Funding	(43.0)
<u>History, Arts, and Libraries</u>	
Elimination of Library Preservation Projects	(1.0)
Reduction of Arts and Cultural Grants by 3.8%	(0.4)
<u>Information Technology</u>	
Continuation of Reductions in Executive Order 2005-03	(8.1)
Other Statewide Information Technology Reductions	(2.1)
<u>Management and Budget</u>	
Unspecified Reductions in State Contracts	(30.0)
<u>Military and Veterans Affairs</u>	
Armory Closures	(0.3)
<u>Natural Resources</u>	
Law Enforcement Programs	(1.0)
<u>K-12 School Aid</u>	
Reduction of GF/GP Grant to School Aid Fund	(244.5)
<u>State Police</u>	
Closure of Three Local Posts	(1.1)
Fire Investigation Program Reductions	(3.4)
<u>Treasury - Operations</u>	
Personal Property Tax Auditors	(2.5)
Other Reductions Statewide	(22.1)
Total Funding Reductions	\$(635.4)

Table 9 provides a summary of the funding shifts that are included in the GF/GP budget recommendations. These funding shifts do not increase or decrease the overall level of any specific State program, but simply substitute GF/GP appropriations to offset the loss of Federal or State Restricted funding or reduce GF/GP funding to offset increases in Federal or State Restricted funding. The primary department affected by these fund shifts is the Department of Community Health. The State Medicaid program has numerous instances in which Federal or State Restricted revenue has either increased or decreased from the prior-year level, forcing adjustments in GF/GP appropriations. The net effect of these fund shifts is a \$185.1 million increase in GF/GP appropriations.

Table 9

FY 2005-06 Governor's Recommendation Major Fee Increases/Funding Shifts to Increase/(Reduce) GF/GP (Millions of Dollars)	
<u>Department/Program</u>	
<u>Capital Outlay</u>	
State Agency Special Maintenance Fund Shift to GF/GP from State Restricted	\$2.0
<u>Community Health</u>	
Medicaid (Physician Quality Assessment to Offset GF/GP Funding).....	(40.0)
Medicaid (Federal Match Rate Adjustment)	9.8
Medicaid (Shift from Tobacco Tax Funds to GF/GP Funding)	119.5
Medicaid (Shift to GF/GP to Replace Loss of Federal Funding)	161.2
Medicaid (Various Other Shifts from GF/GP to State Restricted Funding)	(33.0)
Community Mental Health Provider Assessment to Offset GF/GP Funding	(35.0)
Medicaid (Shift from Use of Merit and Tobacco Settlement to GF/GP).....	54.5
<u>Environmental Quality</u>	
Fund Shift of State Revolving Fund Program.....	5.8
<u>Family Independence Agency</u>	
Fund Shift for Homeless Shelter Contracts	(1.7)
Foster Care Fund Shift.....	(2.9)
Child Care Support System Fund Shift	(4.4)
<u>Higher Education</u>	
Funding Shift of WSU Psychiatric Research Program to Federal Funds	(5.6)
Funding Shift of University of Detroit Dental Clinics.....	(4.5)
<u>History, Arts, and Libraries</u>	
Mackinac Island State Park Fee Increase	(1.5)
<u>Judiciary</u>	
Court Equity Fund Shift to State Restricted Funding.....	(2.2)
<u>Labor and Economic Growth</u>	
Funding Shift of Life Sciences Grants to Bond Proceeds	(20.0)
<u>State</u>	
Fund Shift for Branch Offices to Restricted Transportation Funding.....	(10.0)
<u>State Police</u>	
School Bus Inspections Charged to Local School Districts.....	(1.2)
Michigan Commission on Law Enforcement Standards Shift to State Restricted.....	(2.0)
<u>Treasury - Debt Service</u>	
Quality of Life Bond Debt Service Fund Shift to GF/GP	2.9
Various Other Statewide Fund Shifts	(6.6)
Total Fund Shifts	\$185.1

FY 2004-05 Recommended Appropriation Adjustments

As previously mentioned, the Governor's FY 2005-06 State Budget Message includes a series of recommended adjustments to the enacted FY 2004-05 budget. These adjustments are needed to eliminate an FY 2004-05 GF/GP budget deficit of \$386.6 million. This projected budget deficit results from current estimated revenues falling below the estimate on which the FY 2004-05 GF/GP budget was based and appropriation adjustments since the original budget was enacted.

Table 10 provides a summary of the overall plan submitted by the Governor to eliminate this \$386.6 million FY 2004-05 GF/GP budget deficit. The Governor is recommending that the deficit be eliminated from a combination of GF/GP appropriation reductions and revenue adjustments. The appropriation adjustments included in an Executive Order to reduce appropriations and a negative supplemental appropriation bill total \$305.3 million. The proposed revenue adjustments total \$81.3 million. The largest of the proposed revenue adjustments is a \$73.8 million transfer from the Budget Stabilization Fund to the General Fund.

Table 10 Governor's Proposal to Balance FY 2004-05 General Fund/General Purpose Budget (Millions of Dollars)	
Projected Year-End Balance.....	\$(386.6)
Appropriation Reductions:	
Executive Order 2005-03 Appropriation Reductions	219.9
Negative Supplemental Appropriation Items	85.4
Subtotal	305.3
Revenue Adjustments:	
Withdrawal from Budget Stabilization Fund.....	73.8
Escheats Enforcement	2.5
Professional Employer Organization Base Adjustment	5.0
Subtotal	81.3
Total Recommended Adjustments to Budget.....	\$386.6
Adjusted Year-End Balance.....	\$ 0.0

Table 11 provides a summary of the \$219.9 million of FY 2004-05 appropriation reductions that are contained in the Governor's proposed Executive Order to reduce appropriations. The largest item in this set of appropriation reductions is a \$99.5 million reduction in the level of the GF/GP grant to the School Aid Fund. Other major reductions include departmental administrative reductions and a \$30.0 million reduction in the operational funding for universities and community colleges.

Table 12 provides a summary of the \$85.4 million of appropriation reductions that are contained in the Governor's proposed negative supplemental appropriation bill. The largest of these reductions are a \$25.9 million GF/GP fund shift in the Medicaid program and \$18.5 million of reductions from a Medicaid provider 4.0% reduction.

Table 11

Governor's Proposed FY 2004-05 Executive Order Major Recommendations to Reduce GF/GP Appropriations (Millions of Dollars)	
K-12 School Aid (Reduce GF/GP Grant to School Aid Fund)	\$(99.5)
Departmental Administrative Reductions.....	(51.3)
Higher Education Operations.....	(25.1)
Community College Operations	(4.9)
Agriculture Experiment Station (MSU) Reduction.....	(0.8)
Cooperative Extension Service (MSU) Reduction	(1.6)
Family Independence Agency (Day Care Waiting Period)	(10.0)
Various GF/GP Reductions Offset with Federal and State Restricted Funding	(9.8)
Liquor Licensing and Enforcement Program	(1.0)
Various Departmental Appropriation Lapses	(15.9)
Total Executive Order Reductions	\$(219.9)

Table 12

Governor's Proposed FY 2004-05 Appropriation Reductions Major Negative Supplemental Appropriations (Millions of Dollars)	
Negative Supplemental Appropriation Items	
Medicaid (Offset GF/GP with Medicaid Benefits Trust Fund)	\$(25.9)
Medicaid (Reduce Certain Provider Rates by 4% to Hospitals, Nursing Homes, Physicians, and Other Providers)	(18.5)
Higher Education (Fund Shift for University of Detroit Dental Clinic and Wayne State University Psychiatric Research and Training Program)	(10.1)
State (Fund Shift from GF/GP to Transportation Administration Collection Fund for Branch Office Operations)	(10.0)
Medicaid (Fund Shift to Various Local and State Restricted Revenue Sources).....	(7.2)
Medicaid (6.0% Provider Tax on Community Mental Health)	(6.0)
Cancellation of Youth Correction Facility Contract.....	(5.9)
Agriculture (Fund Shift to Agriculture Equine Industry Development Fund)	(0.7)
Corrections (Close Benton Harbor and Saginaw Corrections Centers).....	(0.6)
Judiciary (Fund Shift Restricted Revenue for GF/GP)	(0.5)
Total Negative Items.....	\$(85.4)

Federal Funds Assumptions

The recommended appropriation of \$12.8 billion of Federal funds in the overall State budget is based on Federal budget policy currently in place. The FY 2006 Federal budget is not likely to pass before October 1, 2005, and the Federal funding assumptions used in the State budget assume that the level of Federal funds authorized in Michigan in FY 2005-06 will be equal to the level of Federal funds received in FY 2004-05. The exceptions to this assumption involve Federal funds for matching programs that may be growing or declining or the already known phase-out of existing Federal funds. As is typically the case with the State budget, after the State's fiscal year begins and the final action on the Federal budget is completed, significant adjustments likely will be made in the level of Federal funds appropriated.

State Revenue Sharing

The Governor's FY 2005-06 budget recommendation contains a continuation of State revenue sharing appropriations to cities, villages, and townships from the levels appropriated in FY 2004-05. State revenue sharing payments to cities, villages, and townships will be frozen in FY 2005-06 at the appropriated FY 2004-05 levels. Counties will continue to make withdrawals from special reserved funds in lieu of revenue sharing payments. The reserve funds were created and withdrawals authorized as part of a phased-in shift in the collections date for county property tax collections.

General Budget Language

The budget includes several recommendations concerning standard budget boilerplate language. The budget continues past practice of freezing classified State employment levels unless exceptions are granted by the State Budget Director. The recommendation also includes language to provide for appropriations of unanticipated Federal, State Restricted, and Local and Private funds through a contingency fund transfer process. This type of appropriation transfer was eliminated beginning in the FY 2003-04 appropriation bills.

Proposed Fee Increases

Table 13 provides a summary of the fee increases recommended in the Governor's FY 2005-06 budget message. The Governor is recommending fee increases totaling \$28.9 million. These fee increases include captive cerividae fees, environmental fees, unspecified fee increases at the Mackinac Island State Park, school bus inspection fees, and criminal history fees. The largest fee increase proposed in the budget is a \$23.0 million increase from liquor license fees.

Table 13

FY 2005-06 Governor's Proposed Fee Increases (Actual Dollars)		
Department/Budget Area	Type of Fee	Estimate of New FY 2005-06 Revenue
Agriculture/Natural Resources	Captive Cervidae Licensing and Inspection Fees.....	\$465,300
Environmental Quality	Wetland Protection Fees.....	1,000,000
	Inland Lakes and Streams Fees	1,000,000
	Critical Dune Management Fees	184,500
History, Arts, and Libraries	Mackinac Island State Park, unspecified fee increase	1,499,100
Labor and Economic Growth	Liquor License Fee for Retail Establishments	23,000,000
State Police	School Bus Inspection Fees.....	1,238,100
	Criminal History Name Check Fee for Nonprofit Associations	500,000
Total Recommended Fee Increases.....		\$28,887,000

Unclassified Salaries

The budget generally includes no funding increases for unclassified salaries above the amount appropriated in the current fiscal year.

State Classified Employee Funding Increases

On December 15, 2004, the Civil Service Commission approved a multiple-year collective bargaining agreement with State civil service employees. The multiyear agreement covers salary adjustments for FY 2005-06, FY 2006-07, and FY 2007-08. The Governor's budget includes the recommendation to the Legislature to approve the FY 2005-06 pay increases for State employees. Under the terms of the collective bargaining agreement, State civil service employees would receive a 1.0% pay increase on October 1, 2005, and an additional 1.0% pay increase on April 1, 2006. The estimated cost of this pay increase is \$41.3 million.

The Governor's FY 2005-06 budget recommendation does not include the funding for these negotiated pay increases. State departments would be forced to absorb the pay increase cost within existing appropriations. The Governor's budget does include funding for the cost increase associated with health care and pension costs for State employees. In addition, the Governor's budget recommendation includes additional funding reflecting the elimination of employee concessions that were built into the FY 2004-05 budget, but will not be included in the FY 2005-06 budget. Table 14 provides a summary of the employee cost increases built into

the FY 2005-06 budget recommendation. These employee cost increases total \$299.2 million of Gross appropriations and \$155.6 million of GF/GP appropriations.

Table 14

Economic Costs Included in Governor's FY 2005-06 State Budget Recommendations (Millions of Dollars)		
Economic Adjustment	Gross Appropriations	GF/GP Appropriations
Elimination of FY 2004-05 Employee Concessions	\$144.2	\$ 76.3
Employee Insurance Cost Increases	69.5	37.5
State Employee Retirement Cost Increases	90.2	44.3
Worker's Compensation Cost Adjustments.....	(4.7)	(2.5)
Total Economic Adjustments	\$292.2	\$155.6

Tobacco Settlement Appropriations

The Governor's budget recommendation includes the appropriation of \$288.9 million of tobacco settlement funds from the Merit Award Trust Fund and the Tobacco Settlement Trust Fund. These tobacco settlement appropriations are summarized in Table 15. The major change in tobacco settlement appropriations in FY 2005-06 compared with FY 2004-05 involves increased funding for the Merit Award Scholarship program and reduced funding for the Medicaid program. The funding increase for the Merit Award Scholarship program results from the appropriation of the full-year cost of the scholarships. Funding for the scholarship during FY 2004-05 has been reduced due to changes in the accounting of the scholarships.

Program Transfers

The Governor's budget recommendation includes transfers of funding for several programs from a department in which the funding for the program was appropriated in FY 2004-05 to a new department in FY 2005-06. Table 16 provides a summary of these program transfers. The largest program transfers recommended by the Governor are the movement of the Michigan State Fair from the Department of Agriculture to the Department of Management and Budget and the movement of the funding of the Wayne State University - Joseph Young Psychiatric Research Center and the University of Detroit - Mercy dental clinics from the Higher Education appropriation bill to the Department of Community Health.

Table 15

Tobacco Settlement Appropriations (Actual Dollars)			
Department/Program	FY 2004-05 Year-to-Date Appropriations	FY 2005-06 Gov's Rec. Appropriations	Dollar Change
<u>Merit Award Trust Fund</u>			
<u>Community Health</u>			
Medicaid Base Funding	\$110,675,000	\$50,300,000	\$(60,375,000)
<u>Education</u>			
Michigan Education Assessment Program.....	13,685,200	16,300,000	2,614,800
<u>Higher Education</u>			
Merit Award Scholarships.....	61,400,000	121,000,000	59,600,000
Tuition Incentive Program	10,250,000	12,000,000	1,750,000
Nursing Scholarship Program	4,000,000	4,000,000	0
Operations Funding	9,500,000	9,500,000	0
<u>Treasury</u>			
Merit Award Board.....	1,580,400	1,636,800	56,400
Tuition Incentive Program Administration.....	385,100	399,700	14,600
Michigan Education Savings Program	1,000,000	1,000,000	0
Information Technology	393,000	400,400	7,400
Transfer to General Fund	5,250,000	0	(5,250,000)
Total Merit Award Trust Fund Appropriations	\$218,118,700	\$216,536,900	\$(1,581,800)
<u>Tobacco Settlement Trust Fund</u>			
<u>Attorney General</u>			
Legal Services	368,200	386,800	18,600
<u>Community Health</u>			
Senior Prescription Drug Program	25,500,000	3,900,000	(21,600,000)
Nursing Home Personal Needs Allowance	5,000,000	5,000,000	0
Senior Respite Care Services	5,000,000	5,000,000	0
Medicaid Base Funding	30,625,000	58,100,000	27,475,000
<u>Labor and Economic Growth</u>			
Life Sciences Funding	10,000,000	0	(10,000,000)
Transfer to General Fund	1,750,000	0	(1,750,000)
Total Tobacco Settlement Trust Fund Appropriations	\$78,243,200	\$72,386,800	\$(5,856,400)
Total Tobacco Settlement Appropriations.....	\$296,361,900	\$288,923,700	\$(7,438,200)

Table 16

Summary of Program Transfers					
From:	Fund Source	FY 2004-05 Transferred Out	To:	Fund Source	FY 2005-06 Gov.'s Rec.
Agriculture					
Michigan State Fair	Gross GF/GP	\$5,486,100 0	Management and Budget	Gross GF/GP	\$5,486,100 0
Michigan Agriculture Surplus System - Food Bank	Gross GF/GP	630,500 630,500	Family Independence Agency	Gross GF/GP	630,500 630,500
Labor and Economic Growth					
Volunteer Investment Grants	Gross GF/GP	250,000 250,000	Family Independence Agency	Gross GF/GP	250,000 250,000
Michigan Virtual University	Gross GF/GP	1,000,000 1,000,000	School Aid	Gross GF/GP	1,000,000 1,000,000
Higher Education					
WSU - Joseph F. Young Psychiatric Research	Gross GF/GP	5,605,900 5,605,900	Community Health	Gross GF/GP	5,605,900 0
Dental Clinics - University of Detroit - Mercy	Gross GF/GP	4,547,000 4,547,000	Community Health	Gross GF/GP	4,547,000 0
State Police					
Information Technology - four positions	Gross GF/GP	342,800 342,800	Information Technology	Gross GF/GP	342,800 342,800

Department/Budget Areas

Agriculture: The recommendation represents a 10.9% reduction in Adjusted Gross appropriations and a 5.0% reduction in GF/GP appropriations. A portion of these reductions is attributable to the transfer of two programs from the budget, Michigan State Fair and the Food Bank grant. The Michigan State Fair (\$5.5 million Gross and \$0 GF/GP) is transferred to the Department of Management and Budget pursuant to Public Act 468 of 2004. The Michigan Agricultural Surplus System (MASS) program (\$630,500 Gross and GF/GP) is transferred to the Family Independence Agency. Factoring out these transfers, the reductions to Adjusted Gross and GF/GP appropriations are 5.6% and 3.0%, respectively. The Department expects about \$1.8 million less from the Federal government for its Emerald Ash Borer Program in FY 2005-06.

Attorney General: Other than an increase of \$240,000 in State Restricted revenue for 2.0 FTEs related to legal costs associated with litigation involving tax reverted property, there are no major changes in this budget.

Capital Outlay: There are two major issues in the Governor's recommendation for Capital Outlay. The first is an authorization to spend \$100.0 million in State Building Authority (SBA) bond revenue for special maintenance projects at colleges and universities. These funds would be reimbursed to institutions based on the proportion of their FY 2004-05 enacted appropriations for operations. The size of the special maintenance awards would range from \$742,900 at Lake Superior State University to \$18,770,400 at the University of Michigan - Ann Arbor, and from \$123,800 at West Shore Community College to \$1,787,000 at Macomb Community College. The recommendation specifies that the projects would have to be contracted out, be limited to existing facilities, and be at least \$100,000 in scope at universities, and \$10,000 in scope at community colleges. Projects would have to be completed by the end of calendar 2007 to be eligible for reimbursement, and would be eligible retroactively to October 1, 2004. Debt service for the \$100.0 million authorization, once fully implemented, is estimated to be \$10 million a year for 12 to 15 years.

The second major issue is the recommended increase of \$25.0 million Gross and \$31.0 million GF/GP for SBA rent (debt service) on past construction projects. This 13.0% increase for rental payments is due to the financing of a number of previously authorized construction projects at colleges, universities, and State agencies. The State rents the facilities from the SBA, which uses the rental money to pay off bonds sold to finance construction.

Civil Rights: The recommendation includes the elimination of the \$99,900 Quality Control System. This program ensures the development and implementation of a performance measurement system that measures cycle time quality, cost, and customer satisfaction. Reductions to the Contact Management System Project (\$80,000) and Office Services (\$21,000) also are recommended.

Civil Service: The recommendation includes the continuation of \$229,300 in FY 2004-05 Executive Order reductions along with an additional \$494,400 in savings based on administrative efficiencies.

Community Colleges: The recommendation provides a continuation level of support for community college operations, assuming adoption of a \$4.9 million, or 1.76%, reduction to college operations in FY 2004-05. The recommendation indicates that this reduction is to be offset by \$32.8 million (\$16.4 million in FY 2004-05 and \$16.4 million in FY 2005-06) in special maintenance funding appropriated in the capital outlay budget and financed through bonds issued by the State Building Authority. These funds would be reimbursed to colleges based on their proportionate share of the FY 2004-05 enacted appropriations for operations.

Community Health (DCH): The recommendation includes a number of significant changes. Net GF/GP funding would increase by \$362.7 million. These changes include a large increase in the Medicaid base, a large GF/GP increase due to the continued phasing

out of Medicaid special financing mechanisms, a series of fund source shifts, economics, program reductions, a number of new initiatives requiring State and/or Federal approval, and other changes. The Governor's budget includes the following changes:

Medicaid Base Funding. There is a \$486.5 million Gross and \$214.3 million GF/GP increase for the entire Medicaid base, including Community Mental Health (CMH) and Children's Special Health Care Services (CSHCS). This increase is predicated on an assumed FY 2005-06 Medicaid caseload of just over 1.5 million. The current caseload is just over 1.42 million and has increased by 350,000 over the last five years, so the base adjustment appears to be in line with the caseload trend.

Medicaid Special Financing. The budget reflects the continued phase-out of so-called Medicaid special financing mechanisms, with an increased cost of \$211.2 million GF/GP. A new special financing proposal, projected to save \$50.0 million GF/GP, is discussed below.

Fund Source Adjustments. The recommendation reflects the change in the Federal Medicaid match rate from 56.71% to 56.59%, which will increase State GF/GP costs by \$9.8 million. The budget also reflects the fact that \$119.5 million of the funding from the 2004 tobacco tax increase will no longer go to the Medicaid Benefits Trust Fund, but instead will go to the State General Fund. The Governor replaces this Medicaid Benefits Trust Fund revenue with \$119.5 million GF/GP for the Medicaid budget.

Various shifts in Tobacco Settlement funding from Medicaid to other non-DCH programs would lead to a \$54.5 million increase in GF/GP appropriations. Finally, additional tobacco tax and other revenue recognized in the proposed FY 2004-05 supplemental would lead to \$30.0 million of GF/GP savings.

Economics and Other Changes. Salary, wage, insurance, and retirement costs would increase by \$30.3 million Gross and \$12.6 million GF/GP. Other changes not discussed here result in a cost increase of \$4.0 million GF/GP.

After the items above are accounted for, funding for the FY 2005-06 DCH budget would increase by \$586.1 million GF/GP. The final budget is over \$200.0 million GF/GP lower than this figure. The decreases necessary to reduce these GF/GP costs are achieved through typical programmatic cuts as well as proposed GF/GP savings initiatives that will require Federal waivers, Federal approval, and/or State statutory changes.

Program Reductions not Requiring Federal Approval or Statutory Changes. The proposed budget includes a number of program reductions that could be achieved through approval of the budget, with no further action required.

The Governor has proposed a 4.0% cut in rates paid to most Medicaid providers, effective May 1, 2005. Medicaid payments to hospitals, physicians, nursing homes, home health, and other providers would be reduced. Health Maintenance

Organizations (HMOs) and the pharmacy dispensing fee would not be cut. The full-year FY 2005-06 savings from these reductions would be \$145.9 million Gross and \$63.5 million GF/GP.

The Governor also proposed eliminating Medicaid chiropractic services as a covered benefit, for savings of \$600,000 GF/GP. The Executive budget includes a change in Medicaid eligibility to close a loophole allowing annuities and other trusts to be exempt from spend-down provisions. This would save \$8.0 million GF/GP.

GF/GP Savings Initiatives Requiring Further Federal and/or State Statutory Changes. A significant portion of the Governor's FY 2005-06 recommendation relies on assumed changes in statutes to be passed by the Legislature as well as waivers and plan amendment approvals by the Federal government. Some of these initiatives are more likely than others to receive the necessary approval.

Estate Recovery. The recommendation assumes a \$10.0 million Gross and \$4.3 million GF/GP savings from implementation of an estate recovery program. The estimated savings appear to be within reason if an authorizing statute is passed by the Legislature and a program is implemented by October 1, 2005.

Physician QAAP. The recommendation includes a proposal for a provider tax, a Quality Assurance Assessment Program (QAAP), on physician services. The budget detail reflects a provider tax, raising a little over \$90.0 million in revenue. The State would keep \$40.0 million of that revenue to supplant GF/GP. The remaining revenue would be used to increase Medicaid physician rates, resulting in a Medicaid increase of over \$120.0 million. The net gain for physicians would be over \$30.0 million, although physicians that do not accept Medicaid patients would pay the tax but would not see any increased revenue. Physicians with a very low Medicaid volume would pay the tax but likely would not get enough of a Medicaid increase to make up for the lost revenue. On the other hand, physicians with anything above a minimal Medicaid volume would see significant increases in revenue.

The proposal would require a statutory change by the Legislature as well as Federal approval. The U.S. Department of Health and Human Services (HHS) has been looking more closely at QAAP proposals of late and while it would appear, based on past experience, that a physician QAAP would meet Federal muster, there are proposals in President Bush's FY 2006 budget to crack down on such mechanisms (discussed below). As such, Federal approval cannot be assumed and, in any event, may not occur in time for the start of FY 2005-06.

Items Requiring Federal Waivers or Other Federal Approval.

CMH QAAP. The Governor's budget also includes a proposed QAAP on Community Mental Health Medicaid services, with savings to the State of \$35.0 million GF/GP. There is a loophole in Federal regulations allowing QAAPs to be limited to

Medicaid managed care entities. (Such a loophole does not exist for hospital, nursing home, physician, or other QAAPs.) The administration proposes modeling a CMH QAAP on one recently approved by HHS for the State of Pennsylvania.

Assuming that the QAAP will be identical to the one in Pennsylvania, it is probable that approval would occur in due course. It should be noted, however, that the administration is assuming a starting date of August 1, 2005, which may not be workable given the time it takes for HHS to approve QAAP proposals. It also should be noted that the Bush administration's FY 2006 budget proposes ending the "Medicaid HMO" loophole, which would make this proposal impossible to implement.

Changes in Medicaid Coverage and Eligibility. The recommendation includes assumed savings of \$17.3 million GF/GP from changes to Medicaid eligibility, which would require Federal waivers. The budget would freeze enrollment for the 19- and 20-year-old eligibility group, thus eliminating coverage for this group over a two-year period as currently covered individuals turn 21 and lose eligibility. The budget also would limit benefits for the 19- and 20-year-olds as well as the optional caretaker relative coverage group, with limitations on hospital days, limitations on the number of prescriptions per month, and elimination of hearing, vision, speech, and physical therapy services. These changes would require a Federal waiver.

Furthermore, the State will seek a waiver to eliminate the three-month "lookback" period for newly eligible Medicaid recipients. Medicaid covers medical bills for three months before the date of application once a person is ruled eligible, and a waiver would be needed to eliminate the lookback period.

Family Planning Waiver. The recommendation includes a proposal to expand family planning coverage, at a 90% Federal match, with an expectation that these services, which do not include abortion services, would lead to a decline in unplanned pregnancies and childbirth costs. The budget assumes \$7.8 million GF/GP savings. Federal approval for this type of waiver has occurred in a number of other states and would likely occur in Michigan.

HMO Actuarial Soundness Waiver. The original assumption when the FY 2004-05 budget was approved was that there would be a two-year 15% increase in Medicaid HMO rates, 7.5% each year, to meet new Federal requirements for actuarially sound Medicaid HMO rates. The Governor's recommendation assumes approval of a waiver exempting the State from the actuarial soundness requirement, thus averting the need for another 7.5% rate increase. If this waiver is not approved, the State would face at least a \$50.0 million GF/GP cost increase.

Medicaid Special Financing. The recommendation includes a new special financing mechanism, involving assessments on HMOs associated with public hospitals, with a payment to the hospitals by the State, projected to save \$50.0 million GF/GP. The State has been successful in getting new special financing mechanisms approved in the past, but will face a shortfall if this mechanism is not approved by HHS.

Medicare Part D Costs. The Medicare drug benefit will take effect in 2006. The State will no longer directly pay for pharmaceuticals used by dual eligible Medicare/Medicaid clients. Instead, the State will have to pay an estimated amount of money based on actual past expenditure, updated by inflation factors. The Governor's budget assumes that this will result in no change in GF/GP costs for the State. It is possible that the cost update factors to be used by the Federal government will exceed the actual cost increases faced by the State and thus will increase GF/GP costs.

Potential Changes Related to the Bush Administration FY 2005-06 Budget. The President's proposed Federal budget would eliminate the Medicaid HMO loophole. If approved, this would cost the State over \$50.0 million GF/GP in the HMO line and prevent the State from implementing a CMH QAAP, costing another \$35.0 million GF/GP. Other QAAP mechanisms would be phased down; the provider tax maximum would go from 6.0% to 3.0% over several years, starting in FY 2006-07. If approved, this change would lead to either increased costs or rate cuts in the nursing home line item starting in FY 2006-07. It also appears that the President's budget would phase out more special financing mechanisms starting in FY 2006-07. This would not affect FY 2005-06, but the Bush administration's views as reflected in its FY 2006 budget proposal may lead to more reluctance to approve such new mechanisms.

In summary, the Governor's recommendation for DCH includes a number of hard cuts to providers and recipients, and a number of funding mechanisms that depend on further State and Federal approval. The Medicaid base reflects realistic caseload trend assumptions, but the budget as a whole is heavily dependent on State statutory changes and approval of waiver and State Plan amendments by the Federal government.

Corrections: The recommendation represents a Gross increase of 5.5% and a GF/GP increase of 5.7%. More than the entire \$97.5 million overall increase can be attributed to economics, including elimination of FY 2004-05 employee concessions savings, insurance and retirement increases, and worker's compensation savings. Major program increases in the Department's budget recommendation include \$15.0 million in new community and prisoner re-entry initiatives to control prison growth, almost \$3.9 million for the full-year costs of beds opened in FY 2004-05, over \$8.0 million for salary step adjustments due to increasing staff seniority, over \$2.0 million in additional substance abuse testing and treatment funds, and other increases approximating \$2.5 million. These increases are offset by a net decrease of over \$14.0 million due to facility closures, security level reductions, and an increase in the number of beds in dorm cubicles; a total decrease of almost \$9.8 million from Conditional Reintegration and Community Residential Program funding; and other Department-wide consolidations, efficiencies, and reductions totaling nearly \$11.0 million.

Education: The recommendation increases the budget by 11.3% Adjusted Gross and by 6.4% GF/GP. These percentages translate to \$11.6 million in additional funding, of which \$6.7 million is Federal funding, \$2.7 million is Merit Award Trust Fund, and \$1.7 million is GF/GP. Program increases include \$7.1 million for testing (\$2.6 million for costs of changing the High School MEAP to a college entrance exam, \$3.4 million for alternative assessments for disabled students, and \$0.9 million additional Federal testing funds), \$1.6 million for School Breakfast, and \$2.9 million for economic adjustments. Program eliminations include National Board Certification Grants (\$100,000) and Limited License to Instruct (\$150,000).

Environmental Quality: The recommendation represents a 9.2% increase in Adjusted Gross appropriations and a 6.4% increase in GF/GP appropriations. Match funding for Federal dollars in State Revolving Fund loan programs is primarily responsible for the increase in State GF/GP appropriations. One-day revenue bonds of \$16.3 million were used instead of GF/GP in FY 2004-05 for the State required match. Those revenue bond funds are not available at the same level for the next fiscal year and an appropriation of \$5.8 million is recommended for FY 2005-06 to partially restore the General Fund support for the program and allow the State to accept the available Federal money.

An increase in State restricted funds results from a recommended appropriation of \$22.0 million from the Refined Petroleum Fund for the cleanup of petroleum-related leaking underground storage tanks. The Fund is supported with a 7/8 cent per gallon environmental regulatory fee on refined petroleum products sold in the State. This appropriation would establish an annual level of funding for such projects. It is subject to the recommendations of the Refined Petroleum Cleanup Advisory Council and the statutory implementation of the program.

Executive Office: The recommendation maintains current-year funding.

Family Independence Agency: The recommendation increases Gross appropriations by \$130.8 million while decreasing GF/GP appropriations by \$3.1 million. The funding increases include \$136.2 million Gross and \$8.4 million GF/GP for caseloads; \$5.5 million in new Federal funds for Weatherization, Nutrition Education, and Domestic Violence; the transfer of Food Bank (\$630,500) and Volunteer Investment Grant (\$250,000) funds from the Department of Agriculture and the Department of Labor and Economic Growth, respectively; a \$2.8 million fund shift to GF/GP in the Foster Care Program; and economic increases of \$56.5 million Gross and \$19.7 million GF/GP.

Funding reductions and other savings in the recommendation include: a 10.0% reduction (\$7.9 million Gross and \$3.8 million GF/GP) in Juvenile Justice facilities; a Day Care 30-day wait for new family reimbursement (included in EO 2005-03) for savings of \$21.0 million Gross and \$10.0 million GF/GP; reductions of \$3.9 million Gross and \$2.2 million GF/GP in information technology costs; and estimated savings of \$12.8 million Gross and \$5.0 million GF/GP due to program initiatives that may reduce Foster Care caseloads.

Two new units, Community Action and Economic Opportunity, and Adult and Family Services, are developed by line item transfers that eliminate the Family Independence Services Administration Unit and are intended to reflect actual departmental organization. Adjustments of FTE positions include eliminating 14.0 field supervisory and 3.0 human resources employees due to consolidation and centralization of administration functions.

Higher Education: The recommendation continues both the 1.76% across-the-board reduction for the 15 public universities and the transfers of Wayne State University's Psychiatric Research and Training Program and the University of Detroit - Mercy's Dental

Clinics Grant to the Department of Community Health budget that were recommended for FY 2004-05. The recommendation indicates that the 1.76% reduction is to be offset by \$167.2 million (\$83.6 million in FY 2004-05 and \$83.6 million in FY 2005-06) in special maintenance funding appropriated in the capital outlay budget and financed through bonds issued by the State Building Authority. These funds would be reimbursed to universities based on their proportionate share of the FY 2004-05 enacted appropriations for operations.

The FY 2005-06 budget eliminates funding of \$500,000 for Central Michigan University's National Charter Schools Institute and \$82,500 for annual Midwest Higher Education Compact dues. The FY 2005-06 budget continues the FY 2004-05 proposed reductions of 2.5% and 5.8%, respectively, for the Agricultural Experiment Station (AES) and the Cooperative Extension Service (CES). In addition, AES is reduced by another \$2.5 million and CES by another \$5.1 million, for a total reduction over two years of \$3.3 million or 10.0% for AES, and \$6.7 million or 23.4% for CES.

The Governor once again recommends elimination of the Tuition Grant Program for financially needy students at Michigan's independent colleges and universities for savings of \$61.8 million GF/GP. The Tuition Incentive Program (TIP) receives an increase of \$1.75 million from the Merit Award Trust Fund to fund an expanding caseload, and there is an additional \$59.6 million from the Merit Award Trust Fund for the Michigan Merit Award Program. The increase for the Merit Award Program is due primarily to the expiration of a two-year accounting change that allowed the use of Merit Award Trust Fund dollars to balance the State budget.

The FY 2005-06 Merit Award Program recommendation of \$121.0 million reflects payment for the second half of awards due to June 2004 high school graduates and the first half of awards for June 2005 high school graduates. The \$121.0 million does not include funding for the middle school awards. (Fiscal Year 2005-06 is the first year that students could be eligible for this extra award ranging from \$250 to \$500 per qualified student.) The \$121.0 million also does not include funding for any awards for students who attend college outside the State of Michigan. The Governor also proposes the creation of a "new" Merit Scholarship beginning with the high school graduating class of 2007. The new \$4,000 Merit Scholarship would be awarded to students who successfully obtain an associates degree or its equivalent or who earn junior status at a Michigan college or university. For students who receive Pell grants, the new Merit Scholarship would make up the difference between their Federal grant and \$4,000.

History, Arts, and Libraries. The recommendation decreases Gross appropriations by \$904,700 or 1.6%. The proposal eliminates GF/GP support of \$1,499,100 for the Mackinac Island Park Commission, with the expectation that the Commission will increase or create fees sufficient to offset the lost revenue. The recommendation eliminates several programs currently supported by GF/GP, including Preservation and Access for Michigan Project, Book Distribution Centers, Lighthouse Preservation Grants, and two historical grant programs; and there are administrative reductions of \$891,100 GF/GP. Although Arts and Cultural Grants are reduced by \$442,900 GF/GP (3.8%), the recommendation includes a \$300,000 GF/GP grant for the Detroit Public Library.

Information Technology (DIT): The recommendation includes funding increases for several information technology enhancements including \$1.52 million for the Human Resources Optimization Project. This project (total cost \$4.5 million capitalized over three

years) includes hardware, software, and development costs. The Human Resources Optimization Project was implemented in FY 2004-05. It centralizes certain human resource functions (employee self-service, certain personnel transactions, etc.) and consolidates and standardizes human resource transactions throughout State government. Fiscal Year 2004-05 savings from the project totaled \$2.0 million and projected savings for FY 2005-06 total \$1.2 million. Through FY 2008-09 the project is estimated to have cumulative savings of \$25.0 million. Funding for the computer improvements for the Family Independence Agency (FIA) includes \$5.5 million for an Integrated Service Delivery Project and \$3.0 million for a Caseworker Relief Project. Both projects are expected to reduce the need for additional FIA staff.

The DIT budget also includes over \$10.0 million in reductions based on consulting savings, maintaining vacancies, delaying replacement of aging servers, reducing CSS&M, delaying application maintenance, eliminating certain positions, and sharing server space.

Judiciary: The recommendation represents a Gross increase of 1.8% and a GF/GP increase of 1.2%. It includes both spending increases and GF/GP offsets in drug courts, the State Court Administrative Office, Indigent Civil Legal Assistance, and Trial Court Reimbursements due to increasing collections of court fee revenue. Past statutory changes in the number of judgeships, the conversion of part-time probate judges to full-time, and the addition of new judges to the defined contribution retirement system combine to require additional expenditure in judges' compensation. Major program reductions are related to the loss of Federal funds, most of which supported the implementation of the statewide judicial telecommunications network scheduled for completion this year. Finally, increases in employee economics make up the greatest portion of the overall changes to the Judiciary budget.

Labor and Economic Growth: The recommendation increases appropriations by 18.9% while decreasing GF/GP funding by 21.9%. The major increase in the budget is the proposed Michigan 21st Century Jobs Initiative which, if approved by the voters, would provide \$200.0 million in bond proceeds annually beginning in FY 2005-06 for research, development, and commercialization programs in advanced automotive technology, advanced materials and manufacturing, alternative energy, life sciences, and homeland security. This would replace the Technology Tri-Corridor Program, reducing GF/GP funding by \$20.0 million and Tobacco Settlement funds by \$10.0 million.

Another major change is in the Low Income and Energy Efficiency Fund grants, which would increase by \$15.0 million. The proposed increase in liquor license fees would increase liquor license fee revenue by \$23.0 million, financing increases in Liquor Law Enforcement Grants. It also would replace Liquor Purchase Revolving Fund money to allow a lapse to the State General Fund of approximately \$13.1 million. The Liquor Purchase Revolving Fund would be used to increase Fire Protection Grants by \$3,710,500.

Increased personnel are proposed for the Office of Financial and Insurance Services, boiler inspections, and elevator inspections – all paid from State restricted funds. Increased Federal funds are available as follows: \$10.0 million for Payments on Behalf of Tenants for the Michigan State Housing Development Authority, \$4.0 million for Remonumentation Grants, \$3.0 million for Adult Basic Education, \$2.13 million for the Office of Workforce Development, and \$1.0 million for the Energy Office.

Legislature: The recommendation maintains the current year level of funding.

Management and Budget (DMB): The most significant increase is funding for a new Purchasing/Procurement System. The System would provide for an online statewide marketplace, provide access to small businesses, provide for increased competition for State business, and allow for reverse auctions to facilitate efficient purchases for the State. Other funding increases result from the transfer of the State Fair to the DMB from the Department of Agriculture (\$5,486,100) and the restoration of lease payments for Cadillac Place (\$10.7 million) due to the restructuring of payments to reduce costs in FY 2003-04 and FY 2004-05.

Proposed boilerplate language would require the DMB to reduce statewide contractual General Fund expenditures by \$30.0 million. The language authorizes the State Budget Director to take any actions necessary to record expenditure reductions properly as part of the financial transactions for FY 2005-06. The new E-procurement system is an integral part of the Department's plan to achieve required savings. The budget also includes \$500,000 in pension funds to provide for disaster planning back-up continuity for the Retirement Systems.

The budget provides for reductions to various programs, including: mail delivery, savings related to the purchase of Constitutional Hall, and savings resulting from in-sourcing security staff.

Military and Veterans Affairs: The recommendation proposes the closure of six National Guard Armories, the continuance of full funding for grants to Veterans Service Organizations at \$3.9 million GF/GP, and full funding of \$4.0 million for the Challenge Program for at-risk youth. The budget includes additional GF/GP for the rising costs of military retirements, additional U.S. Department of Defense funds in support of the State's role in maintaining military training sites and support facilities, and new Federal Homeland Security grants.

Natural Resources: The recommendation represents a 2.6% increase in Adjusted Gross appropriations and an 8.1% decrease in GF/GP appropriations. The GF/GP decrease is largely attributable to a proposed \$1.6 million reduction in GF/GP support for law enforcement activities. Of this reduction, \$0.6 million would be replaced with State restricted funds. The recommendation would achieve the \$1.0 million net reduction to the program by revising the responsibilities of conservation officers. While the officers have general law enforcement authority similar to that of State Police troopers, the officers would focus almost exclusively on enforcement of game and wildlife laws and would address law violations in other areas only in severely limited circumstances. This recommendation would be implemented beginning in FY 2004-05 to generate GF/GP savings immediately.

School Aid: The recommendation increases Gross appropriations by \$281.8 million or 2.2% compared with enacted FY 2004-05 appropriations. Each school district would see an increase of \$175 per pupil in FY 2005-06 (a 2.6% increase in the basic foundation allowance). In addition, each district would receive \$50 per high school pupil (defined as grades 9-12). At-Risk funding would increase by \$33.0 million, or more than 10.0%. Intermediate School District (ISD) operational funding would increase by 2.6%, or

more than \$2.0 million. Other State funding increases include Special Education (\$55.2 million), Center for Educational Performance and Information (CEPI) (\$2.7 million), Michigan Virtual High School (\$1.0 million), and various obligation payments totaling \$50.8 million. The Freedom to Learn (6th grade laptops) program is eliminated in the Governor's recommended budget.

While the Governor proposes to reduce the GF/GP grant to the K-12 budget by \$244.5 million from the year-to-date FY 2004-05 level, School Aid Fund revenue would increase by \$443.3 million (which includes \$47.9 million from tax policy changes). In addition, the Governor proposes to reform the School Bond Loan Fund program into a revolving fund; capitalizing the proceeds yields more than \$40.0 million in both FYs 2004-05 and 2005-06. Total Federal funds also increase by \$20.5 million.

Pursuant to recommendations in the Lieutenant Governor's Commission on Higher Education and Economic Growth report, the following changes are included in the Governor's proposed School Aid Act: 1) an incentive program is established, beginning in FY 2006-07, to place emphasis on graduating pupils using a rigorous curriculum; 2) CEPI is provided additional funding to establish a database for lifelong tracking of students, from preschool through college; and 3) the Michigan Virtual High School is charged with developing and making available online the Michigan Scholar Curriculum, a rigorous curriculum detailing required credits and courses.

The recommended budget includes three other items of note: the retirement rate is increased from 14.87% to 16.34% in FY 2005-06; a planning grant is established for ISDs to determine best practices to perform district administrative functions efficiently; and Section 166, which imposes a 5.0% financial penalty on districts that dispense prescriptions for family planning drugs or make referrals for abortions, is repealed.

State: The major adjustment to the budget is a funding shift that also is included in the Governor's FY 2004-05 proposed supplemental appropriation bill. The recommendation would increase Transportation Administration Collection Fund (TACF) revenue by diverting funding currently deposited in the Michigan Transportation Fund (MTF) from vehicle registration transfers and expedient title fees. The additional revenue to the TACF would amount to approximately \$10.0 million, which would offset a \$10.0 million GF/GP reduction for the Department of State. The proposal would require amendments to the Michigan Vehicle Code.

State Police: The recommendation includes the closure of three police posts, the absence of a trooper replacement school, and the continuation of considerable Federal support for Homeland Security, including new funds for motor carrier enforcement at border crossings. Other changes consist mostly of budgetary savings, consolidations, and fund shifts to reduce overall GF/GP expenditure, including a plan to require school districts to pay for State safety inspections of school buses (until now a cost assumed by State GF/GP), and a plan to charge nonprofits for name criminal history checks for the first time.

Transportation: The recommendation represents a 4.2% increase in Adjusted Gross appropriations. The budget includes a proposal to shift \$10.9 million in Michigan Transportation Fund revenue to the Transportation Administration Collection Fund to support the operations of the Secretary of State. This diversion will reduce the amount of MTF revenue earmarked to the

Comprehensive Transportation Fund (\$1.1 million), the State Trunkline Fund (\$3.8 million), county road commissions (\$3.8 million), and cities and villages (\$2.2 million). The budget also reflects the second year of the two-year phase of the “bridge penny split” legislation. This will increase State funding for local bridges by \$12.7 million and reduce funding for State bridges by the same amount. Also, the budget reflects funding increases for scheduled debt service, totaling \$73.0 million Gross, Federal revenue to State and local road agencies of \$10.7 million Gross, and State revenue to local road agencies (county road commissions and cities and villages) of \$17.1 million Gross.

The budget recommendation includes a proposal to continue the diversion of approximately \$11.2 million of sales tax revenue from the Comprehensive Transportation Fund (CTF) to the General Fund. Public Act 139 of 2003 reduced the amount of motor vehicle-related sales tax revenue deposited in the CTF. This reduction is scheduled to expire at the end of FY 2004-05. The Governor’s budget proposal would continue this redirection in FY 2005-06. However, the Governor’s budget does not include the one-time \$10.0 million redirection of CTF revenue to the General Fund included in FY 2004-05. As a result, CTF appropriations are increased by \$13.0 million. Of the total increase, \$12.4 million is associated with increases for new bus purchases and bus operating grants.

Treasury - Debt Service: The recommendation includes adjustments based on existing debt service requirements and the anticipated sale of \$50.0 million in Clean Michigan Initiative Bonds.

Treasury - Operations: The recommendation includes new boilerplate language providing incentives for increased revenue collections obtained through personal property tax audits. An additional \$500,000 is included to increase investment returns by actively managing State investments. The Governor also is recommending \$500,000 for an Escheats Enforcement Audit Program. The Governor estimates that this program would generate an additional \$10.0 million in escheats revenue for the State. Funding related to statutory programs is adjusted based on requirements and revenue estimates. The budget includes various reductions to meet spending targets.

Treasury - Revenue Sharing: The recommendation essentially freezes revenue sharing payments to each city, village, and township (CVT) at the FY 2004-05 level. The freeze would result in an estimated 934 CVTs (approximately 52% of all cities, villages, and townships), not receiving any payments in FY 2005-06 under statutory revenue sharing provisions, although these local units would continue to receive constitutional revenue sharing payments. Statutory revenue sharing payments would not be made to these local units because 536 are not expected to receive a statutory payment in FY 2004-05 and another 398 CVTs are expected to receive so little in statutory funds in FY 2004-05 that eliminating the statutory payment would be insufficient to offset the growth the CVT would receive in constitutional payments. Under the recommendation, given current revenue estimates, the City of Detroit would be expected to receive approximately 52.0% of the statutory appropriation for revenue sharing. Enacting the freeze would require additional legislation to alter the current distribution formula. The recommendation also includes \$212,000 of GF/GP revenue to hold units under the control of a State-appointed financial manager (Highland Park), harmless from revenue sharing reductions enacted in Executive Order 2003-23.

Payments to Local Units of Government

The Governor's FY 2005-06 budget recommendation includes \$15.8 billion of estimated payments to local units of government. This exceeds the required level of payments to local units of government pursuant to Article IX, Section 30 of the State Constitution of 1963 by \$2.4 billion. Table 17 provides a summary of this estimate.

Table 17

State Payments to Local Units of Government Article IX, Section 30 Requirement (Millions of Dollars)	
	FY 2005-06 Estimate
State Spending from State Resources.....	\$25,211.7 ¹⁾
Required Payments to Local Units of Government (48.97%).....	13,325.6
Actual or Estimated Payments to Locals	15,755.4
Actual Percentage of Total State Spending	57.90%
Surplus of Section 30 Payments.....	2,429.8
¹⁾ Does not include \$35.0 million of Federal aid counted as GF/GP revenue.	

State Employment

Table 18 and Figure E provide a comparison of classified and full-time equated (FTE) positions recommended by the Governor for FY 2005-06 with the appropriated level of FTEs during FY 2004-05. The Governor's FY 2005-06 budget recommendation includes funding for 56,282.4 FTEs. This represents a decline of 732.4 FTEs or 1.3% from the current fiscal year.

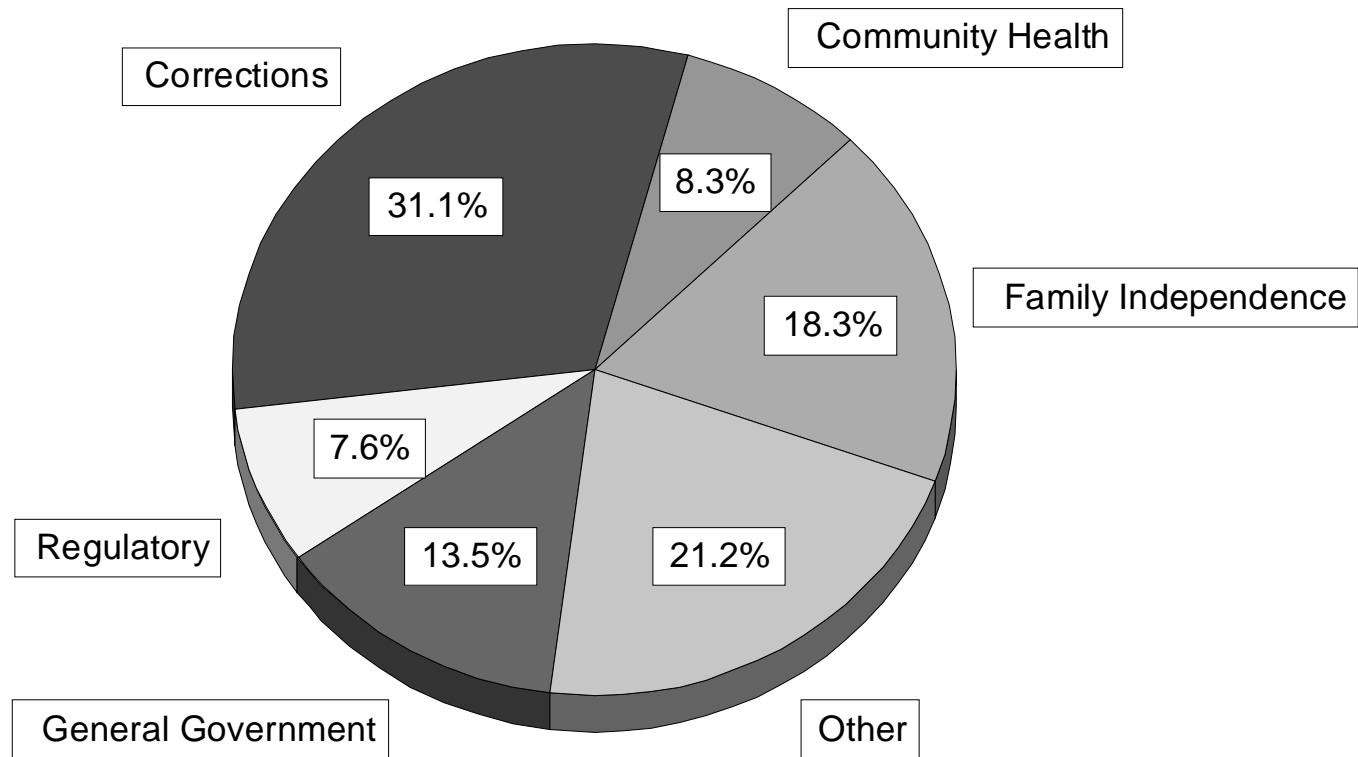
Table 18

**Full-Time Equated Positions
FY 2004-05 Versus Governor's Recommendation**

Department/Budget Area	FY 2004-05 Year-to-Date Appropriations	FY 2005-06 Governor's Recommendation	Position Change	Percent Change
Agriculture.....	743.0	694.0	(49.0)	(6.6)%
Attorney General	558.0	560.0	2.0	0.4
Civil Rights.....	136.0	136.0	0.0	0.0
Civil Service	240.5	240.5	0.0	0.0
Community Health	5,112.6	4,693.1	(419.5)	(8.2)
Corrections	17,753.8	17,529.2	(224.6)	(1.3)
Education.....	413.0	425.0	12.0	2.9
Environmental Quality	1,564.2	1,562.2	(2.0)	(0.1)
Executive	74.2	74.2	0.0	0.0
Family Independence Agency	10,302.0	10,280.0	(22.0)	(0.2)
History, Arts, and Libraries	232.0	232.0	0.0	0.0
Information Technology	1,756.4	1,760.4	4.0	0.2
Judiciary.....	582.5	582.5	0.0	0.0
Labor and Economic Growth	4,256.5	4,266.5	10.0	0.2
Management and Budget (Operations)	725.0	745.0	20.0	2.8
Military Affairs	1,016.0	1,016.0	0.0	0.0
Natural Resources	2,064.5	2,068.2	3.7	0.2
State	1,851.8	1,851.8	0.0	0.0
State Police	2,948.0	2,897.0	(51.0)	(1.7)
Transportation	3,031.3	3,030.3	(1.0)	(0.0)
Treasury (Operations)	1,653.5	1,638.5	(15.0)	(0.9)
Total Positions	57,014.8	56,282.4	(732.4)	(1.3)%

Figure E

Full-Time Equated Positions FY 2005-06 Governor's Recommendation



Total = 56,282.4

Projected Year-End Balances

Combining the Governor's FY 2005-06 appropriation recommendations with the consensus revenue estimate and recommended revenue policy changes leads to updated estimates of the FY 2005-06 GF/GP and School Aid Fund year-end balances. Assuming that all of the Governor's revenue and appropriation recommendations are enacted, the FY 2005-06 GF/GP budget will close the fiscal year with a \$3.7 million year-end balance. The FY 2005-06 School Aid Fund budget will close the fiscal year with a zero year-end balance. Tables 19 and 20 provide a summary of these estimates.

Table 19 FY 2005-06 Budget General Fund/General Purpose Revenue, Expenditure, and Year-End Balance (Millions of Dollars)	
Revenue:	
Beginning Balance	\$0.0
<u>Other Revenue Adjustments:</u>	
Consensus Revenue Estimate	8,156.2
Revenue Sharing Freeze	396.1
County Revenue Sharing Suspension	182.3
Cap Interfund Borrowing Rates	20.0
Nonuse of SBT Pharmaceutical Credit	10.0
Land Sales	10.0
Escheats Revenue	10.0
Subtotal Revenue	8,784.6
<u>Governor's Recommended Revenue Adjustments:</u>	
Tax Policy Changes	64.0
Agriculture Equine Industry Development Fund Transfer	6.1
Comprehensive Transportation Fund Transfer	11.1
Liquor License Fee Increase	13.0
Subtotal Governor's Recommended Revenue Adjustments	94.2
Total Estimated Revenue.....	\$8,878.8
Expenditure:	
Governor's Appropriation Recommendations	\$8,875.1
Projected Year-End Balance	\$3.7

Table 20 FY 2005-06 Budget School Aid Fund Revenue, Expenditure, and Year-End Balance (Millions of Dollars)	
Revenue:	
Beginning Balance	\$23.7
Consensus Revenue Estimate	11,300.9
Other Revenue Adjustments:	
Payments in Lieu of Taxes	(2.0)
GF/GP Grant.....	20.2
Governor's Recommended Tax Policy Changes	47.9
School Bond Loan Fund Reform Proposal	44.5
Federal Revenue	<u>1,374.1</u>
Subtotal Other Revenue Adjustments	<u>1,484.7</u>
Total Estimated Revenue.....	\$12,809.3
Expenditure:	
Governor's Appropriation Recommendation.....	<u>\$12,809.3</u>
Projected Year-End Balance	\$0.0

ECONOMIC AND REVENUE FORECAST

Economic Forecast

The Governor's proposed budget for FY 2005-06 is based on the economic forecast adopted at the January 14, 2005, Consensus Revenue Estimating Conference. The general theme of this economic forecast is that the renewed economic growth that the U.S. economy already is experiencing will finally spread to Michigan in 2005 and 2006. Nationally, the economy began to pull out of the protracted economic slowdown in 2003 and then continued to grow in 2004, but Michigan's economy remained sluggish at best. As the national economy continues to grow and expand, however, it is projected that Michigan's economy finally will experience renewed growth in the next two years due to the fact that the key driving force behind Michigan's economy is the national economy. Key components of this consensus economic forecast are presented in Table 21, and the forecast highlights for both the U.S. and Michigan economies are summarized below.

U.S. Economy. The national economy began to exhibit renewed growth during the second half of 2003 and this continued through 2004. During this time, the stock market rebounded, consumer confidence improved to historically high levels, employment increased every month since September 2003, initial unemployment claims edged downward, manufacturing activity increased, and business profits improved. Economic activity is expected to continue to improve in 2005 and 2006.

Real Gross Domestic Product (GDP) increased 4.4% in 2004, which was the third strongest annual rate of economic growth in the past 20 years. Real GDP will continue to grow at an estimated rate of 3.2% in both 2005 and 2006.

Inflation, as measured by the U.S. Consumer Price Index (CPI), is expected to stay at relatively low levels and under control through 2006. While the rate of inflation increased from 2.3% in 2003 to 2.7% in 2004, largely due to the spike in oil prices, the rate of inflation is expected to moderate slightly over the next two years to rates of 2.6% in 2005 and 2.5% in 2006.

Employment will continue to improve, but the growing economy also will attract new entrants to the labor force, so the unemployment rate is not expected to show much improvement over the next two years. The jobless rate will average an estimated 5.4% in 2005, which would be down only slightly from 5.5% in 2004, and then edge back up to an estimated 5.5% in 2006.

Light vehicle sales will total an estimated 16.8 million units in 2005, after totaling 16.7 million units in 2004. In 2006, light vehicle sales are expected to remain at a relatively strong level of 16.8 million units.

Michigan Economy. While the recession ended nationally in November 2001, as established by the National Bureau of Economic Research, Michigan's economy still has not made a clear and distinct break from the prolonged weakness in economic activity. While there have been some encouraging improvements in key economic indicators nationally, Michigan economic performance has not produced much good news. Key to Michigan's ongoing sluggish economy is the lack of any growth in employment. This weakness in the labor market can be traced to the manufacturing sector. The manufacturing industries are in a very fierce battle to stay competitive in the global marketplace. Businesses in Michigan, and elsewhere, have invested in new equipment in an effort to become more efficient and more competitive, which has dramatically increased productivity over the past few years. While productivity improvements are desirable and needed for a growing economy in the long run, in the short run, productivity gains can lead to lost jobs and this is Michigan's current dilemma. Nevertheless, given that 1) the national economy experienced strong growth in 2004, 2) the pace of economic growth nationally is expected to remain strong in 2005 and 2006, and 3) the pace of productivity is expected to slow and in fact, already began to slow down in the last part of 2004, it is estimated that Michigan's economy will finally turn the corner to renewed economic growth in 2005 and then experience even stronger growth in 2006.

Wage and salary employment is expected to increase 0.3% to 4.38 million workers in 2005, after declining 1.1% in 2004. In 2006, the rate of employment growth is expected to accelerate to 1.0% to a level of 4.42 million workers. While declining employment levels have been the key to Michigan's economic weakness during the past four years, increasing employment levels will be the key to renewed economic growth in 2005 and 2006.

The unemployment rate will edge up to 6.9% in 2005, from 6.7% in 2004, and then edge down to an estimated 6.8% in 2006.

Personal income, which provides the broadest measure of overall economic activity in Michigan, will increase an estimated 4.5% to \$337.5 billion in 2005, after increasing only 2.7% in 2004. In 2006, the rate of increase will accelerate to an estimated 5.6%, which will push personal income up to \$356.4 billion. Personal income measures the total income received by individuals from all sources, including wages and salaries, interest, dividends, proprietors' income, and transfer payments.

Table 21

Consensus Economic Forecast: 2005 and 2006 January 13, 2005						
	Calendar 2004	% Change From Prior Year	Calendar 2005 Forecast	% Change From Prior Year	Calendar 2006 Forecast	% Change From Prior Year
United States:						
Real Gross Domestic Product (billions of chained 1996 dollars)	\$10,838	4.4%	\$11,185	3.2%	\$11,540	3.2%
Consumer Price Index (1982-84=100)	189.0	2.7	193.9	2.6	198.6	2.4
3-Month Treasury Bills (Interest Rate, %)	1.4	---	2.4	---	3.6	---
Unemployment Rate (Civilian - %)	5.5	---	5.4	---	5.5	---
Light Vehicle Sales (millions of units)	16.7	0.5	16.8	0.6	16.8	0.6
Michigan:						
Wage and Salary Employment (thousands)	4,363	(1.1)	4,376	0.3	4,420	1.0
Unemployment Rate (Civilian - %)	6.7	---	6.9	---	6.8	---
Personal Income (billions of dollars)	\$322.9	2.7	\$337.5	4.5	\$356.4	5.6
Real Personal Income (billions of 1982-84 \$s)	\$173.8	0.9	\$177.3	2.0	\$183.2	3.3
Detroit Consumer Price Index (1982-84=100)	185.8	1.8	190.3	2.4	194.5	2.2

Revenue Estimates

Based on the economic forecast summarized above, it is estimated that revenue totaling \$40.7 billion will be available in FY 2005-06 to support Governor Granholm's proposed budget. This represents a 3.4% increase from the revised revenue estimate for FY 2004-05. This total State government revenue includes revenue from taxes, fees, interest, licenses and permits, penalties, fines,

Federal aid, carryover balances, and the Governor's proposed tax policy changes. Table 22 presents the overall State budget revenue estimates for FY 2004-05 and FY 2005-06, broken down by major fund.

Table 22

Governor's Projected Total State Revenue: FY 2004-05 and FY 2005-06 (Millions of Dollars)					
Fund	FY 2003-04 Final	FY 2004-05 Estimate	% Change FY 2005/ FY 2004	FY 2005-06 Estimate	% Change FY 2006/ FY 2005
General Fund/General Purpose:					
Beginning Balance	\$ 174.0	\$ 0.0	(100.0)%	\$ 0.0	---
Revenue From Ongoing Sources ¹⁾	8,042.0	7,869.8	(2.1)	8,156.2	3.6%
Proposed Tax/Revenue Changes	0.0	7.5	----	104.2	1,289.3
One-Time Revenue Adjustments & Other	480.8	640.0	33.1	618.4	(3.4)
Total GF/GP Revenue	<u>\$8,696.8</u>	<u>\$8,517.3</u>	(2.1)	<u>\$8,878.8</u>	4.2
School Aid Fund:					
Beginning Balance	113.7	74.1	(34.8)	23.7	(68.0)
Ongoing Earmarked Tax & Lottery Revenue ¹⁾	10,615.4	10,878.9	2.5	11,300.9	3.9
Proposed Tax/Revenue Changes	0.0	41.1	----	92.4	124.8
Other Revenue (GF Grant, Fed. aid, etc.)	1,645.6	1,616.2	(1.8)	1,392.3	(13.9)
Total SAF Revenue	<u>\$12,374.7</u>	<u>\$12,610.3</u>	1.9	<u>12,809.3</u>	1.6
Other Funds:					
General Fund/Special Purpose:	13,636.8	13,873.3	1.7	13,932.5	0.4
Transportation Funds	4,270.0	4,411.2	3.3	4,766.9	8.1
Other Special Revenue Funds:					
Beginning Balances	105.1	181.9	73.1	108.2	(40.5)
Revenue Current Period	<u>941.3</u>	<u>791.5</u>	(15.9)	<u>977.4</u>	23.5
Subtotal Other Special Revenue Funds	1,046.4	973.4	(7.0)	1,085.6	11.5
Other Revenue	159.9	229.3	43.4	232.5	1.4
Total Other Funds W/ Beginning Balance	<u>19,113.1</u>	<u>19,487.2</u>	2.0	<u>20,017.5</u>	2.7
Gross Revenue	\$40,184.6	\$40,614.8	1.1%	\$41,705.6	2.7%
Less Interfund Transfers	<u>(1,706.7)</u>	<u>(1,276.2)</u>	(25.2)	<u>(1,043.1)</u>	(18.3)
Net Total Revenue	\$38,477.9	\$39,338.6	2.2%	\$40,662.5	3.4%

1) Estimates adopted at the January 13, 2005, Consensus Revenue Estimating Conference.

Source: Governor's Executive Budget for FY 2005-06, Appendix E, and Senate Fiscal Agency.

General Fund/General Purpose and School Aid Fund

Two of the major funds in the overall State budget are the General Purpose portion of the General Fund (GF/GP) and the School Aid Fund (SAF). These two funds account for an estimated \$21.7 billion, or 53%, of the total revenue estimated for FY 2005-06. A breakdown of the GF/GP and SAF revenue estimates for FY 2004-05 and FY 2005-06 is presented in Tables 23 and 24. The estimates for GF/GP and SAF revenue derived from ongoing revenue sources and enacted tax policy changes are the consensus estimates adopted by the Granholm Administration, Senate Fiscal Agency, and House Fiscal Agency at the January 13, 2005, Consensus Revenue Estimating Conference. In addition to the consensus estimates, the total GF/GP and SAF revenue estimates include the Administration's estimates of one-time revenue adjustments, grants and transfers, Federal aid, beginning carryover balances, and the impact of the Administration's proposed tax increases and revenue adjustments.

General Fund/General Purpose Revenue. As shown in Table 23, GF/GP revenue is expected to total \$8.88 billion in FY 2005-06, which represents a 4.2% increase from the FY 2004-05 revised estimates. The forecasted improved level of economic activity will help boost the revenue from ongoing State taxes and nontax items by an estimated 3.6%, and the Governor's proposed tax increases and other revenue adjustments will accelerate the overall GF/GP revenue growth to 4.2%. The proposed tax increases are described below and will generate an estimated \$64.0 million in additional GF/GP revenue. The other proposed revenue changes will produce an additional \$30.0 million in GF/GP revenue in FY 2005-06, including \$10.0 million from a planned increased effort to ensure that unclaimed property held by businesses is being turned over to the State in a timely manner; a \$6.1 million transfer from the Agriculture Equine Industry Development Fund (which equals the estimated amount this Fund will receive from the casino gaming tax in FY 2005-06); \$11.1 million in increased sales tax revenue from extending a reduction in the amount of sales tax earmarked to the Comprehensive Transportation Fund that is currently in effect for FY 2004-05; and \$13 million from a proposed additional transfer from the Liquor Purchase Revolving Fund.

School Aid Fund. School Aid Fund revenue available for spending in FY 2005-06 will total an estimated \$12.79 billion and this estimate is summarized in Table 24. The SAF revenue estimate for FY 2005-06 includes ongoing earmarked tax and lottery revenue totaling an estimated \$11.3 billion, a grant from the GF/GP budget of \$20.2 million, and Federal aid of \$1.37 billion. In addition, the Governor's proposed tax increases will generate an estimated \$47.9 million in new SAF revenue in FY 2005-06, as presented in Table 20, and the Governor's proposal to restructure the School Bond Loan Fund will generate an estimated \$44.5 million in new SAF revenue.

Table 23

General Fund/General Purpose Revenue Estimates FY 2004-05 and FY 2005-06 (Millions of Dollars)			
	FY 2004-05	FY 2005-06	Percent Change
Beginning Balance	\$0.0	\$0.0	---
Consensus Estimates for Ongoing Revenue Sources: ¹⁾			
<u>Taxes</u>			
Net Income Tax	3,919.0	4,072.9	3.9%
Single Business Tax	1,855.7	1,905.2	2.7
Sales	117.2	112.7	(3.8)
Use	912.8	950.3	4.1
Cigarette	122.8	233.6	90.2
Insurance Company Premiums	239.3	243.0	1.5
Telephone & Telegraph	95.3	79.3	(16.8)
Estate	39.0	10.0	(74.4)
Casino	42.9	42.9	0.0
All Other Taxes	169.0	163.5	(3.3)
Subtotal Taxes	7,513.0	7,813.4	4.0
Nontax Revenue	356.9	342.8	(4.0)
Total GF/GP Consensus Revenue Estimates	\$7,869.9	\$8,156.2	3.6%
Enacted Revenue Adjustments ²⁾	639.9	628.4	(1.8)
Proposed Tax Increases ³⁾	5.0	64.0	1,180.0
Proposed Budget Adjustments ⁴⁾	2.5	30.2	---
Total GF/GP Revenue with Beginning Balance	\$8,517.3	\$8,878.8	4.2%
1) Estimates adopted at the January 13, 2005, Consensus Revenue Estimating Conference.			
2) Includes the following: FY 2004-05 - \$511.1 million in increased sales tax revenue due to reduced revenue sharing payments, \$20.0 million from capping interfund borrowing rates, \$10.0 million from an unused pharmaceutical credit, \$31.4 million from the sale of State property, and \$67.5 million from other adjustments. FY 2005-06 - \$578.4 million in increased sales tax revenue due to reduced revenue sharing payments, \$20.0 million from capping interfund borrowing rates, \$10.0 million from an unused pharmaceutical credit, and \$10.0 million from the sale of State property.			
3) Includes the following: FY 2004-05 - \$5.0 million from changing how professional employer organizations are taxed. FY 2005-06 - proposed tax increases presented in Table 25.			
4) Includes the following: FY 2004-05 - \$2.5 million from increased escheats enforcement. FY 2005-06 - \$10.0 million from increased escheats enforcement, \$6.1 million transfer from Agriculture Equine Fund, \$11.1 million in increased sales tax revenue from the Comprehensive Transportation Fund, and \$13.0 million transfer from the Liquor Purchase Revolving Fund.			

Table 24

School Aid Fund Revenue Estimates FY 2004-05 and FY 2005-06 (Millions of Dollars)			
	FY 2004-05	FY 2005-06	Percent Change
Beginning Balance	\$74.1	\$23.7	(68.0)%
Consensus Estimates for Earmarked Tax & Lottery Revenue: ¹⁾			
Sales Tax & Use Tax.....	5,344.3	5,584.0	4.5
Income Tax.....	1,956.9	2,036.9	4.1
State Education Property Tax	1,846.0	1,943.9	5.3
Real Estate Transfer Tax.....	310.0	312.0	0.6
Tobacco Taxes	479.9	474.4	(1.1)
Casino Gaming Tax.....	98.0	100.0	2.0
Other Tax Revenue	193.8	193.8	0.0
Subtotal Taxes.....	10,228.9	10,645.0	4.1
Lottery.....	649.9	655.9	0.9
Subtotal Earmarked Tax and Lottery Consensus Estimate	\$10,878.8	\$11,300.9	3.9%
GF/GP Grant	264.7	20.2	(92.4)
Federal Aid and Other	1,351.5	1,372.1	1.5
Proposed Tax Increases ²⁾	0.0	47.9	---
Proposed Revenue Changes ³⁾	41.1	44.5	8.3
Total SAF Revenue with Beginning Balance	\$12,536.1	\$12,785.6	2.0%
1) Estimates adopted at the January 13, 2005, Consensus Revenue Estimating Conference.			
2) Proposed tax increases described in <u>Table 25</u> .			
3) Includes the following: \$41.1 million in FY 2004-05 and \$44.5 million in FY 2005-06 from restructured School Bond Loan Fund to cover bond debt service costs.			

Proposed Tax Increases

The Governor's budget proposes to eliminate or reduce certain tax provisions that currently offer special tax reductions for certain taxpayers. Eliminating these provisions will result in additional tax revenue in FY 2005-06. These proposed tax increases would have an impact on the oil and gas severance, sales, use, income, and property taxes. In total, these proposed tax increases would generate an estimated \$112.5 million. Of this amount, an estimated \$64.0 million would go into the GF/GP budget, \$47.9 million would go to the SAF, and about \$0.6 million would increase revenue sharing payments. These proposed tax increases are summarized below, and their estimated fiscal impacts are presented in Table 25.

Table 25

Governor's Proposed Tax Increases: FY 2005-06
(Dollars in Millions)

Proposed Tax Increase	State Government Fiscal Impact			
	GF/GP	School Aid Fund	Other	Total
Oil and Gas Severance Tax				
Tax marginal wells at the same rate as all other wells.....	\$2.2	\$0.0	\$0.0	\$2.2
Sales and Use Taxes				
Eliminate special use tax exemptions for all international and certain interstate calls	14.6	7.3	0.0	21.9
Replace current total exemption for interstate trucks with a partial exemption	5.6	10.8	0.6	17.0
Eliminate sales and use tax exemptions for motion pictures purchased or leased by theaters	10.7	9.3	0.0	20.0
Tax all food and beverages sold through vending machines and mobile vendors.....	6.7	18.5	0.0	25.2
Repeal sales tax exemption for items purchased by inmates from prison stores	0.2	0.5	0.0	0.7
Income Tax				
Eliminate deduction for certain indirect costs incurred by oil and gas producers	4.0	1.0	0.0	5.0
State Utility Property Tax				
Repeal railroad company credits against the State utility property tax.....	20.0	0.0	0.0	20.0
State Education and Property Taxes				
Repeal exemptions for water softeners and water coolers ¹⁾ ..	0.0	0.5	0.0	0.5
Total Proposed Tax Increases	\$64.0	\$47.9	\$0.6	\$112.5
¹⁾ Repealing these exemptions also would generate an estimated \$0.7 million in local property taxes.				

Oil and Gas Severance Tax

Marginal Wells. The value of oil and natural gas extracted from wells is taxed at rates of 6.0% and 5.5%, respectively; however, oil and natural gas extracted from so-called “marginal wells,” which generate only small amounts of oil and gas, are taxed at a rate of 4.0%. The Governor is proposing to eliminate this special tax rate and instead tax oil and gas from the marginal wells at the same rates as all other wells are taxed. These proposed changes would generate an estimated \$2.2 million, all of which would go to the General Fund.

Sales and Use Taxes

Inmate Purchases. Items purchased by inmates from prison stores are not subject to the sales tax. The Governor’s proposal would eliminate this exemption. This change would increase sales tax revenue by an estimated \$0.7 million, of which \$0.2 million would go to the General Fund and \$0.5 million would go to the SAF.

International Telecommunications. International telephone calls and certain interstate calls (including toll-free number, WATTS services, and private lines) are exempt from the use tax, while all other long-distance calls are subject to the use tax. Under this proposal, all of these calls would be subject to the use tax. This would generate an estimated \$21.9 million, of which \$14.6 million would go to the General Fund and \$7.3 million would go to the SAF.

Interstate Trucks and Trailers. Trucks, trailers, and parts purchased in Michigan are subject to the sales tax. However, these vehicles are totally exempt from the sales tax if 10% or more of their travel will be outside of Michigan. The proposal would eliminate this current total exemption, and replace it with a partial exemption equal to the percentage of the miles that will be traveled outside of Michigan. This partial exemption would produce an estimated \$17.0 million, which would be distributed as follows: \$5.6 million to GF/GP revenue, \$10.8 million to the SAF, and \$0.6 million to revenue sharing.

Motion Pictures. Motion pictures purchased or leased by movie theaters to show to the public are exempt from the sales and use taxes. This proposal would eliminate these exemptions, which would generate an estimated \$20.0 million. Of this amount, \$10.7 million would go to the General Fund and \$9.3 million would go to the SAF.

Vending Machines. Food sold for immediate consumption, including food heated or chilled through vending machines, is subject to the sales tax; however, milk, juice, nonalcoholic drinks, and other food sold through vending machines are exempt from the sales tax. This proposal would eliminate these exemptions. The Governor’s budget estimates that this would generate \$25.2 million, of which the General Fund would receive \$6.7 million and the SAF would receive \$18.5 million.

Income Tax

Oil and Gas Deduction. Oil and natural gas production is subject to the oil and gas severance tax and, as a result, the income generated from oil and gas production is exempt from the income tax. Under current law, however, oil and gas producers still may deduct certain indirect costs, such as depreciation expenses, from their adjusted gross income (AGI) even though the income from oil and gas production is not included in the AGI. The Governor is proposing that this deduction for indirect costs be repealed. This would increase income tax revenue by an estimated \$5.0 million, which would provide \$4.0 million to the General Fund and \$1.0 million to the SAF.

State Utility Property Tax

Railroad Companies. Railroad companies are essentially exempt from the State utility property tax due to tax credits granted for the cost of maintaining and improving both rights-of-way and railroad cars. This proposal would eliminate these special tax credits and generate \$20.0 million, all of which would go to the General Fund.

State Education and General Property Taxes

Water Softeners. Water softener equipment leased to individuals and bottled water coolers leased to individuals and businesses are exempt from the personal property tax. The Governor is proposing that these exemptions be repealed. This would increase State education property tax revenue, all of which goes to the SAF, by an estimated \$0.5 million. In addition, local property taxes would be increased by an estimated \$0.7 million.



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